Supreme Court, U.S.
FILED

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No. _____

**In the**
**SUPREME COURT OF THE UNITED STATES**

OCTOBER TERM, 1994

John M. O'Quinn, *Petitioner*,

v.

Donna C. Kline, *Respondent.*

Petition for Writ of Certiorari to the
Court of Appeals of Texas, Hosuton [14th District]

# APPENDIX TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES SUPREME COURT

## VOLUME 2

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April 10, 1995

## TABLE OF CONTENTS

Majority Opinion
(Court of Appeals) ..... APPENDIX A

Dissenting Opinion
(Court of Appeals) ..... APPENDIX B

Opinion on Motions for Rehearing
(Court of Appeal) ..... APPENDIX C

Texas Supreme Court's Order Denying the
Application for Writ of Error ..... APPENDIX D

Texas Supreme Court's Order Overruling
the Motion for Rehearing of the
Application for Writ of Error ..... APPENDIX E

Trial Court's Final Judgment ..... APPENDIX F

Arbitrator's Award ..... APPENDIX G

Arbitrator's Denial of Motion to Partially
Modify and Vacate Arbitration Award ... APPENDIX H

Donna C. Kline's Statement of Claim and
Request for Arbitration ..... APPENDIX I

Donna C. Kline's Letter to the American
Arbitration Association with Original
Petition (Arbitration Panel and
Trial Court) ..... APPENDIX J

Brief of Appellee John M. O'Quinn
(Court of Appeals) ..... APPENDIX K

Motion for Rehearing of Appellee
John M. O'Quinn
(Court of Appeals) ..... APPENDIX L

Application for Writ of Error of
Petitioner John M. O'Quinn
(Texas Supreme Court) ..... APPENDIX M

Motion for Rehearing on Application
for Writ of Error of Petitioner
John M. O'Quinn
(Texas Supreme Court) ..... APPENDIX N

O'Quinn's Opposition to Kline's
Application for Decree ..... APPENDIX O

O'Quinn's Motion to Vacate, or,
Alternatively, Modify and Correct
Arbitration Award ..... APPENDIX P

**APPENDIX L**

NO. 14-93-00187-CV

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DONNA C. KLINE,
Appellant,

vs.

JOHN M. O'QUINN
THOMAS J. PEARSON, and
BANK ONE, TEXAS, N.A.,
Appellees

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IN THE COURT OF APPEALS FOR THE
FOURTEENTH DISTRICT OF TEXAS

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MOTION FOR REHEARING OF APPELLEE
JOHN M. O'QUINN

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TO THE COURT OF APPEALS FOR THE FOURTEENTH DISTRICT OF TEXAS:

COMES NOW Appellee John M. O'Quinn ("O'Quinn") and respectfully files this Motion for Rehearing. For the reasons set forth below, O'Quinn prays that this Court reconsider its Opinion of March 24, 1994, and upon rehearing **affirm** the Judgment granted below.

## NAMES OF ALL PARTIES

| | |
|---|---|
| Appellant: | Donna C. Kline |
| Appellant's Counsel: | Norman Riedmueller<br>Michael Pullara |
| Appellee: | John M. O'Quinn |
| Appellee's Counsel: | J. Clark Martin<br>Steven R. Borgman<br>Vinson & Elkins L.L.P. |
| Appellee: | Thomas J. Pearson |
| Appellee's Counsel: | Thomas J. Pearson & Associates<br>Pro se |
| Appellee: | Bank One, Texas, N.A. |
| Appellee's Counsel: | Cheryl E. Irvin<br>Irvin, Clark & Burnett |

## INDEX

NAMES OF ALL PARTIES ..... i

MOTION FOR REHEARING ..... 1

COMPELLING REASONS FOR REHEARING ..... 1

POINTS OF ERROR ON REHEARING ..... 3

ARGUMENT AND AUTHORITIES ..... 4

I. Arbitrators should not be allowed to award punitive damages: (Germane to Point of Error on Rehearing Nos. 1, 3 & 4) ..... 4

A. O'Quinn did not waive his constitutional rights or the constitutional arguments against allowing arbitrators to award punitive damages: (Germane to Point of Error on Rehearing No. 2) ..... 4

B. Because arbitration proceedings do not comply with constitutional limitations on awards of punitive damages, arbitrators should not be permitted to award punitive damages: (Germane to Point of Error on Rehearing No. 3) ..... 6

1. The United States Supreme Court's decisions in ***Haslip*** and ***TXO*** demonstrate the constitutional requirement of safeguards on awards of punitive damages: ..... 6

2. The Texas Supreme Court's decision in ***Moriel*** also demonstrates the importance of safeguards on awards of punitive damages: . . . . . 9

3. The safeguards emphasized by the U.S. Supreme Court and the Texas Supreme Court in ***TXO***, ***Haslip***, and ***Moriel*** are completely absent from arbitration proceedings: . . . . . 13

C. Arbitrators should not be permitted to award punitive damages as a matter of public policy: (Germane to Point of Error on Rehearing No. 4) . . . . . 17

II. This Court erred in holding that the parties submitted the issue of punitive damages to arbitration: (Germane to Point of Error on Rehearing Nos. 1, 5, 7 & 8) . . . . . 20

A. Arbitrators must act within the limitations imposed by the parties' agreement and the law: . . . . . 20

B. This Court's Opinion incorrectly addresses the arbitrators' authority on procedural questions instead of reviewing the award pursuant to Articles 237 and 238: . . . . . 21

C. Ms. Kline's own pleadings and demand for arbitration show that she did not submit the issue of punitive damages to the arbitrators: . . . . . 23

D. The parties' agreement precluded the submission of the question of punitive damages: . . . . . 25

E. The Trial Court's Judgment Should be Affirmed because the arbitrators exceeded their authority: . . . . . 27

III. Ms. Kline was not entitled to punitive damages: . 28

A. Under Texas law, there are special rules applicable to punitive damages: . . . . . 28

B. Ms. Kline also failed to plead and prove the type of intentional conduct necessary to support an award of punitive damages: . . 31

IV. Conclusions: . . . . . 31

## TABLE OF AUTHORITIES

CASES

***Alamo National Bank v. Kraus***,
616 S.W.2d 908 (Tex. 1981) ..... 11, 13, 15

***Amoco Prod. Co. v. Alexander***,
622 S.W.2d 563 (Tex. 1981) ..... 29, 30

***Arnold v. Nat. County Mutual Fire Ins. Co.***,
725 S.W.2d 165 (Tex. 1987) ..... 31

***Atrium Westwood VIII Venture v. Barrick Westwood L.P.***,
693 S.W.2d 699 (Tex. App.--Houston [14th Dist.] 1985,
no writ) ..... 3, 25

***Babcock & Wilcox Co. v. PMAC, Ltd.***, 863 S.W.2d 225
(Tex. App.--Houston [14th Dist.] 1993,
writ pending) ..... 21, 25

***Bellefonte Underwriter's Ins. Co. v. Brown***,
704 S.W.2d 742 (Tex. 1986) ..... 29, 30

***Boyce Iron Works, Inc. v. Southwestern Bell Tel. Co.***,
747 S.W.2d 785 (1988) ..... 5

***Browning-Ferris Indus., Inc. v. Lieck***, 845 S.W.2d 926
(Tex. App.--Corpus Christi 1993, writ granted) ..... 9

***Burk Royalty Co. v. Walls***,
616 S.W.2d 911 (Tex. 1981) ..... 31

***Central Texas Clarklift, Inc. v. Simmons***,
540 S.W.2d 745 (Tex. Civ. App.--Waco 1976,
no writ) . . . . . 2, 26

***Christiansen v. Prezelski***,
782 S.W.2d 842 (Tex. 1990) . . . . . 3, 24, 25

***Crim Truck & Tractor Co. v. Navistar***,
823 S.W.2d 591 (Tex. 1992) . . . . . 29

***Del E. Webb Constr. v. Richardson Hosp. Auth.***,
823 F.2d 145 (5th Cir. 1987) . . . . . 2, 22

***E. I. Du Pont de Nemours & Co. v. Local 900***,
968 F.2d 456 (5th Cir. 1992) . . . . . 21

***Garrity v. Lyle Stuart, Inc.***, 386 N.Y.S.2d 831,
353 N.E.2d 793 (N.Y. 1976) . . . . . 2, 9, 12, 16-19

***Grissom v. Greener & Sumner Constr. Co.***,
676 S.W.2d 709 (Tex. App.--El Paso 1984,
writ ref'd n.r.e.) . . . . . 2, 16, 21, 27

***Gulf Oil Corp. v. Guidry***, 327 S.W.2d 406 (Tex. 1959) . . 24

***House Grain Co. v. Obst***,
658 S.W.2d 903 (Tex. App.--Corpus Christi 1983,
writ ref'd n.r.e.) . . . . . 3, 24

***International Bank, N.A. v. Morales***,
736 S.W.2d 622 (Tex. 1987) . . . . . 29, 30

***Jim Walter Homes, Inc. v. Reed***,
711 S.W.2d 617 (Tex. 1986) . . . . . 29, 30

***John Wiley & Sons, Inc. v. Livingston***,

376 U.S. 543 (1964) ..... 2, 22

***Johnson v. Lynaugh***, 800 S.W.2d 936
(Tex. App.--Houston [14th Dist.] 1990,
writ denied) ..... 5

***Manges v. Guerra***, 673 S.W.2d 180 (Tex. 1984) .... 29, 31

***Oberg v. Honda Motor Co.***, 851 P.2d 1084 (Or. 1993),
*cert. granted*, 62 U.S.L.W. 3470
(U.S. Jan. 14, 1994) ..... 10, 11, 13

***Pacific Mut. Life Ins. Co. v. Haslip***,
499 U.S. 1 (1991) ..... 1, 2, 6-11, 13, 16

***Pool v. Ford Motor Co.***,
715 S.W.2d 629 (Tex. 1986) ..... 13

***Prudential Ins. Co. of Am. v. Jefferson Associates, Ltd.***,
839 S.W.2d 866 (Tex. App.--Austin 1992,
writ granted) ..... 9

***School City of East Chicago, Indiana v. East Chicago Federation of Teachers***,
422 N.E.2d 656 (Ind. Ct. App. 1981) ..... 12, 19

***Seale v. Roy M. Mitchell Contracting Co.***,
321 S.W.2d 149 (Tex. Civ. App.--Austin 1959,
writ ref'd) ..... 20

***Shaw v. Kuhnel & Associates, Inc.***,
698 P.2d 880 (N.M. 1985) ..... 12, 19

***Smith v. Barnett***, 373 S.W.2d 762
(Tex. Civ. App.--Dallas 1963, no writ) ..... 28

***Southwestern Bell Telephone Co. v. Delaney***,
809 S.W.2d 493 (Tex. 1991) . . . . . 29

***Southwestern Bell Telephone Co. v. FDP Corp.***,
811 S.W. 2d 572 (Tex. 1991) . . . . . 29

***Texas Nat'l Bank v. Karnes***,
717 S.W.2d 901 (Tex. 1986) . . . . . 29, 30

***Transportation Ins. Co. v. Moriel***,
37 Tex. S. Ct. J. 450
(Feb. 2, 1994) . . . . . 1, 2, 9-13, 16, 17, 19

***TXO Production Corp. v. Alliance Resources Corp.***,
113 S. Ct. 2711 (1993) . . . . . 1, 2, 6, 8-11, 13, 16

***United States Fidelity & Guaranty Co. v. DeFluiter***,
456 N.E.2d 429 (Ind. Ct. App. 1983) . . . . . 12, 19

***United Steelworkers v. Warrior & Gulf Navigation Co.***,
363 U.S. 574, 582 (1960) . . . . . 21

***USX Corp. v. West***,
781 S.W.2d 453 Tex. App.--Houston [1st Dist.] 1989,
no writ) . . . . . 2, 22-24, 27

***Valero Energy Corp. v. Wagner & Brown***,
777 S.W.2d 564 (Tex. App.--El Paso 1989,
writ denied) . . . . . 20

***Williams v. Khalaf***, 802 S.W.2d 651, 650 (Tex. 1990) . . 1, 5

STATUTES AND RULES

TEX. CIV. PRAC. & REM. CODE
§ 41.003 (Vernon Supp. 1993) . . . . . 31

TEX. CONST. art I, § 19 . . . . . 9

TEX. R. APP. P. 50(d) . . . . . 3, 24

TEX. REV. CIV. STAT. ANN.
art 224 (Vernon Supp. 1993) . . . . . 20

TEX. REV. CIV. STAT. ANN.
art. 238(A)(2) . . . . . 22, 24

TEX. REV. CIV. STAT. ANN.
arts 237 & 238 (Vernon 1973) . . . . . 2, 21, 28

## MOTION FOR REHEARING

TO THE HONORABLE JUSTICES OF THE COURT OF APPEALS:

COMES NOW John M. O'Quinn ("Mr. O'Quinn"), Appellee and Defendant in the Trial Court, who respectfully files this his Motion for Rehearing of this Court's Opinion and Judgment of March 24, 1994. Mr. O'Quinn would respectfully show the Court as follows:

## COMPELLING REASONS FOR REHEARING

Despite holding that Mr. O'Quinn did not owe Appellant Ms. Donna Kline ("Ms. Kline") a fiduciary duty and the absence of any implied tort duty of good faith and fair dealing under well-settled law, the majority nonetheless affirms the arbitrator's award of punitive damages in a contract dispute. This result is contrary to well-settled law and underscores the reasons why a rehearing is particularly appropriate. As detailed below, this Court erred in several important respects in concluding that the Trial Court incorrectly set aside the arbitrators' award of punitive damages.

Among other things, this Court's holding that Mr. O'Quinn waived his constitutional arguments is incorrect. As the Appellee, Mr. O'Quinn was not required to raise every possible alternative theory on which the trial court's judgment could be based. *E.g.*, ***Williams v. Khalaf***, 802 S.W.2d 651, 650 (Tex. 1990). Accordingly, Mr. O'Quinn's constitutional arguments are properly before this Court. Mr. O'Quinn respectfully requests that this Court reconsider these issues.

As detailed in Mr. O'Quinn's earlier briefs filed with this Court, both the U.S. and Texas constitutions impose limitations on awards of punitive damages. The most notable cases limiting awards of punitive damages are ***TXO Production Corp. v. Alliance Resources Corp.***, 113 S. Ct. 2711 (1993); ***Pacific Mut. Life Ins. Co. v. Haslip***, 499 U.S. 1 (1991); and ***Transportation Ins. Co. v. Moriel***, 37 Tex. S. Ct. J. 450 (Feb. 2, 1994). All three of these decisions recognize that certain safeguards must be imposed on the process by which punitive damages are awarded. Despite these decisions and the limitations on punitive awards, this Court's Opinion avoids an analysis of the application of the constitutional limitations on arbitration awards of punitive damages. As detailed below, arbitration proceedings have none of the constitutional safeguards found so important in ***Moriel, TXO,*** and ***Haslip***. Hence, the award of punitive damages by the arbitrators in this case violates the U.S. and Texas constitutions.

This Court also erred in failing to prohibit arbitrators from awarding punitive damages unless the parties specifically agree to give the arbitrators the authority to do so. In its opinion, the Court acknowledged this argument, but nonetheless declined to affirm the Trial Court's Judgment. For the reasons detailed in ***Garrity v. Lyle Stuart, Inc.***, 386 N.Y.S.2d 831, 353 N.E.2d 793 (N.Y. 1976), the public policy of the State of Texas should prohibit awards of punitive damages in arbitration proceedings unless the parties have expressly agreed to submit the issue of punitive damages to arbitration. It is important to note that the Texas Supreme Court's discussion of punitive damages in ***Moriel*** is quite similar to the views expressed by the New York Court of Appeals in ***Garrity***.

This Court's opinion also is in error in connection with the Court's conclusion that the parties in this case

contemplated the arbitration of tort claims and an award of punitive damages. There is nothing whatsoever in the agreements among the parties involving punitive damages. Hence this case is not like ***Grissom v. Greener & Sumner Constr. Co.***, 676 S.W.2d 709 (Tex. App.--El Paso 1984, writ ref'd n.r.e.), where the parties expressly agreed to submit the issue of exemplary damages to arbitration. Moreover, the arbitration clause at issue was narrowly drawn. Hence, arbitration of tort claims was outside the scope of the parties' agreement. *See* ***Central Texas Clarklift, Inc. v. Simmons***, 540 S.W.2d 745 (Tex. Civ. App.--Waco 1976, no writ).

In its Opinion, this Court incorrectly focused on the procedural issues relating to arbitration, relying on ***USX Corp. v. West***, 781 S.W.2d 453 (Tex. App. -- Houston [1st Dist.] 1989, no writ); ***John Wiley & Sons, Inc. v. Livingston***, 376 U.S. 543 (1964); and ***Del E. Webb Constr. v. Richardson Hosp. Auth.***, 823 F.2d 145 (5th Cir. 1987). As detailed below, however, ***John Wiley***, ***Del Webb***, and ***USX*** involved a question not at issue here. Those cases involved the question of whether the procedural steps set forth in the parties' agreement as preconditions to arbitration had been satisfied. This case raises a quite different issue -- was the question of punitive damages submitted? As detailed below, Articles 237 and 238 of the Texas General Arbitration Act *require* the Texas courts to determine whether the arbitration exceeded the scope of their authority and whether they awarded on a matter not submitted to them.

This Court's presumption of evidence to support the arbitrators' award of punitive damages is in error. As pointed out in Justice Ellis's dissent, the single case cited by the majority for this presumption actually created the presumption itself, as the Texas Supreme Court decision cited in ***House Grain Co. v. Obst***, 658 S.W.2d 903, 906 (Tex.

App.--Corpus Christi 1983, writ ref'd n.r.e.), fails to support the use of any presumption of evidence to support an arbitration award. This Court's reliance on ***Obst*** is in error, as this Court should instead presume the exact opposite -- that the evidence supports the Trial Court's Judgment. *See, e.g.*, ***Christiansen v. Prezelski***, 782 S.W.2d 842, 843 (Tex. 1990); ***Atrium Westwood VIII Venture v. Barrick Westwood L.P.***, 693 S.W.2d 699 (Tex. App.--Houston [14th Dist.] 1985, no writ); TEX. R. APP. P. 50(d). As an appellant, the presumption runs against Ms. Kline, not in her favor.

For these and the reasons detailed below, Mr. O'Quinn respectfully requests that this Court rehear and reconsider its Opinion and, upon rehearing, affirm the Trial Court's Judgment in all respects.

## POINTS OF ERROR ON REHEARING

1. This Court erred in reversing the Trial Court's Judgment, which modified the arbitration award to exclude punitive damages from the award. (Op. at 6-12.)

2. This Court erred in holding that Mr. O'Quinn's constitutional arguments were waived. (Op. at 11.)

3. This Court erred in holding that the arbitration award of punitive damages may be affirmed without violating the U.S. or Texas constitutions. (Op. at 11.)

4. This Court erred in failing to adopt and apply as the public policy of Texas a rule that prohibits arbitrators from awarding punitive damages unless the parties have specifically and expressly agreed to give the arbitrators the authority to award such relief. (Op. at 11-12.)

5. This Court erred in reversing the Trial Court's Judgment and awarding punitive damages because there is absolutely no legal basis for an award of punitive damages in this case. (Op. at 6-12 & 14-18.)

6. This Court erred in concluding that the parties agreed to the arbitration of tort claims and especially claims for punitive damages. (Op. at 7-10.)

7. This Court erred in concluding that the award of punitive damages was within the scope of the arbitrators' authority. (Op. at 6-10.)

8. This Court erred in deferring to the arbitrators on the question of whether Ms. Kline's pleadings requested punitive damages, as the Texas General Arbitration Act requires the modification of the award because punitive damages were not submitted. (Op. at 8-10.)

9. This Court erred in presuming that the evidence before the arbitrators supported an award of punitive damages. (Op. at 10.)

## ARGUMENT AND AUTHORITIES

### I. Arbitrators should not be allowed to award punitive damages: (Germane to Point of Error on Rehearing Nos. 1, 3 & 4)

There are two fundamental reasons why arbitrators should not be allowed to award punitive damages in arbitration proceedings conducted pursuant to the Texas General Arbitration Act. First, arbitration proceedings lack the substantive and procedural safeguards required by the Due Process Clause of the United States Constitution and the Due Course of Law Clause of the Texas Constitution.

Second, allowing Arbitrators to award punitive damages is contrary to the public policies of this State. For the reasons discussed below, this Court should therefore affirm the Trial Court's Judgment.

**A. O'Quinn did not waive his constitutional rights or the constitutional arguments against allowing arbitrators to award punitive damages: (Germane to Point of Error on Rehearing No. 2)**

On page 11 of its decision, this Court concluded that Mr. O'Quinn waived his arguments that the United States and Texas Constitutions preclude the award of punitive damages in this case. Mr. O'Quinn respectfully disagrees. As the Appellee, Mr. O'Quinn was not required to argue every alternative theory on which the Trial Court could have based its decision. ***Williams v. Khalaf***, 802 S.W.2d 651, 658 (Tex. 1990); ***Boyce Iron Works, Inc. v. Southwestern Bell Tel. Co.***, 747 S.W.2d 785, 787 (Tex. 1988). The Texas Supreme Court described this rule in ***Wiiliams***:

> Before the reversal by the court of appeals, Williams had obtained a totally favorable judgment with which he was satisfied. In supporting the trial court's action in his Brief to the court of appeals, Williams was under no obligation to argue every alternative theory on which the trial court could base its action. [citation to ***Boyce Iron Works*** omitted].

***Williams***, 802 S.W.2d at 658; ***Oak Park Townhouses v. Brazosport Bank of Texas, N.A.***, 851 S.W.2d 189, 190 (Tex. 1993)(per curiam). These decisions from the Texas Supreme Court make it clear that an appellee has not waived an

alternative basis for supporting the Trial Court's decision simply because appellee did not make the alternative below.

At the first hearing involving the arbitration award, the Trial Court ruled from the bench in favor of Mr. O'Quinn. As detailed in Mr. O'Quinn's earlier briefs, the Trial Court reaffirmed this ruling on several occasions, including at the pretrial conference. Given the Trial Court's rulings, there was no reason for Mr. O'Quinn to assert additional and alternative arguments to support the Trial Court's ruling. As in ***Williams*** and in ***Boyce Iron Works***, Mr. O'Quinn may now raise these alternative grounds for the Trial Court's ruling on appeal. Because these additional grounds for affirmance involve important and fundamental rights under the U.S. and Texas constitutions, it is important for this Court to resolve these issues.

As authority for its conclusion that Mr. O'Quinn waived his constitutional arguments, the Court cites ***Johnson v. Lynaugh***, 800 S.W.2d 936, 939 (Tex. App. -- Houston [14th Dist.] 1990, writ denied). However, ***Johnson*** involved waiver by an appellant, not an *appellee*. Mr. O'Quinn respectfully submits that ***Johnson*** simply does not apply here. Instead, ***Williams*** and ***Boyce Iron Works*** apply. Consequently, Mr. O'Quinn's constitutional arguments regarding the ability of arbitrators to award punitive damages are properly before this Court.

**B. Because arbitration proceedings do not comply with constitutional limitations on awards of punitive damages, arbitrators should not be permitted to award punitive damages: (Germane to Point of Error on Rehearing No. 3)**

The concept of punitive damages has its roots in the English common law and was recognized in early American jurisprudence. Over the past two centuries, courts in our country and in the State of Texas have summarily found that punitive damage awards are constitutional. Only recently has the United States Supreme Court examined the constitutionality of punitive damage awards in the light of Due Process requirements -- both procedural and substantive -- of the Fourteenth Amendment to the United States Constitution. These decisions by the Supreme Court are extremely important because Due Process of law applies to arbitration proceedings; the parties do not waive their right to Due Process of law simply by agreeing that their disputes will be submitted to arbitration.

**1. The United States Supreme Court's decisions in *Haslip* and *TXO* demonstrate the constitutional requirement of safeguards on awards of punitive damages:**

In ***Pacific Mutual Life Ins. Co. v. Haslip***, 111 S. Ct. 1032 (1991), the Supreme Court held that the common law method for assessing punitive damages is not so inherently unfair as to deny Due Process and to be *per se* unconstitutional. The Court went on to hold, however, that unlimited jury discretion -- or unlimited judicial discretion for that matter -- in fixing of punitive damages may invite extreme results that jar one's constitutional sensibilities. ***Id.*** at 1043. The Court held that it need not, and indeed, cannot draw a mathematical bright line between the constitutionally acceptable and the constitutionally unacceptable that would fit every case. The Court said it could, however, say with certainty that general concerns of reasonableness and adequate guidance from the trial court when a case is tried to a jury properly enter into the constitutional calculus. ***Id.*** at 1043.

The Supreme Court in ***Haslip*** indicated that the jury's discretion with respect to punitive damages is constitutional only when a trial court gives the jury reasonable and adequate guidance in making such awards. The Supreme Court noted that under Alabama law, as under the law of most states, punitive damages are imposed for purposes of retribution and deterrence, not to compensate the plaintiff for any injury. The Court observed that the instructions in ***Haslip*** informed the jury that its discretion should be guided by this purpose. ***Id.*** at 1044.

In addition, the Supreme Court in ***Haslip*** indicated that punitive damages are constitutional only when the instructions given to the jury describe the standards to be used by the jury in determining whether to impose such awards. Although juries are given significant discretion in the determination of punitive damages, that discretion is not unlimited. In ***Haslip***, the Court found that the jury's discretion was confined by appropriate instructions to deterrence and retribution and the state policy concerns sought to be advanced. ***Id.*** at 1044. The Court found that the jury was instructed that if punitive damages were to be awarded, the jury "must take into consideration the character and degree of the wrong as shown by the evidence and necessity of preventing similar wrong." ***Id.*** at 1044.

The Supreme Court in ***Haslip*** held that the discretion vested in the jury under the traditional common law rules may be justified as constitutional by the existence of post-trial procedures for scrutinizing punitive damage awards. ***Id.*** at 1044. In ***Haslip***, the Court indicated that the procedures established by the Alabama courts ensured meaningful and adequate review by the trial court whenever a jury fixed the amount of punitive damages. The Court noted that the Supreme Court of Alabama had established post-trial procedures for scrutinizing awards of punitive damages. Under this procedure, Alabama trial courts must state in the record the reasons for interfering with a jury verdict, or refusing to interfere with a jury verdict, on grounds of excessiveness of the damages. Among the factors deemed appropriate for an Alabama trial court's consideration are: (1) the culpability of the defendant's conduct, (2) the desirability of discouraging others from similar conduct, (3) the impact upon the parties, and (4) other factors, such as the impact on innocent third parties. ***Id.*** at 1044. The United States Supreme Court held that this test ensures

meaningful and adequate review by the Trial Court whenever a jury has fixed the punitive damages. ***Id.*** at 1044.

The Court went on to state that the appellate procedures established by the Alabama Supreme Court provide still an additional check on the jury's or trial court's discretion in awarding punitive damages. ***Id.*** at 1045. Under these Alabama procedures, the reviewing court first undertakes a comparative analysis and then it applies detailed substantive standards the Alabama Supreme Court has developed for evaluating punitive awards. In so doing, it makes its review to ensure that the award does not exceed an amount that will accomplish society's goal of punishing and deterrence. ***Id.*** at 1045. The Court noted that this appellate review makes certain that the punitive damages are reasonable in their amount and rational in light of their purpose to punish what has occurred and to deter its repetition. The United States Supreme Court noted that the Supreme Court of Alabama has elaborated and refined specific criteria for determining whether a punitive award is reasonably related to the goals of deterrence and retribution. ***Id.*** at 1045.

The Court concluded that the application of these standards imposes a sufficiently definite and meaningful constraint on the discretion of Alabama fact finders in awarding punitive damages. The Supreme Court held that these standards have real effect when applied by the Alabama Supreme Court to jury awards. The Supreme Court noted that these standards have resulted in the reduction of punitive awards in Alabama and that they provide for a rational relationship in determining whether a particular award is greater than necessary to punish and deter. 111 S.Ct. 1045-46.

In ***TXO Production Corp. v. Alliance Resources Corp.***, 113 S. Ct. 2711 (1993), the United States Supreme Court again reviewed the limits imposed by the Due Process Clause of the Fourteenth Amendment upon the award of punitive damages. The Court concluded that because West Virginia law requires as a matter of fundamental fairness that punitive damages bear a reasonable relationship to compensatory damages or the magnitude of the potential harm that defendant's conduct would have caused to its intended victim if the wrongful plan had succeeded, as well as to the possible harm to the other victims that might have resulted if similar future behavior were not deterred, there was sufficient concern by the West Virginia trial courts with the reasonableness of the award such that the award did not violate the substantive component of the Due Process Clause. ***Id.*** at 2720-721.

Turning to the procedural component of the due process clause, the Court indicated that the inquiry could include whether the punitive damages award is a result of a fundamentally unfair procedure because the jury was not adequately instructed, whether the award was adequately reviewed by the trial or appellate courts, and whether the defendant had no advance notice that the jury might be allowed to return such a large award or to rely on potential harm as a basis for its calculation. The Court declined to address the first argument as it was not argued or passed on below. The Court concluded that in fact the jury's award was adequately reviewed by the trial court and the appellate court and that defendant had notice under prior law that punitive damages could be awarded under the circumstances of the case. Thus, the United States Supreme Court found no procedural violation of Due Process as a result of the procedures used in West Virginia for the awarding of punitive damages. ***Id.*** at 2720-724.

**2. The Texas Supreme Court's decision in *Moriel* also demonstrates the importance of safeguards on awards of punitive damages:**

The Texas Constitution contains its own Due Process Clause. TEX. CONST. art I, § 19. In the last several years, the Texas courts have dealt with the constitutionality of awards of punitive damages. *See, e.g.,* ***Browning-Ferris Indus., Inc. v. Lieck***, 845 S.W.2d 926 (Tex. App.--Corpus Christi 1993, writ granted); ***Prudential Ins. Co. of Am. v. Jefferson Associates, Ltd.***, 839 S.W.2d 866, 876-77 (Tex. App.--Austin 1992, writ granted). In ***Jefferson Associates***, for example, the Court of Appeals for Austin held that a jury's award of punitive damages did not violate the Due Process Clause of the United States Constitution or the Texas Constitution because many of the judicial safeguards relied upon in ***Haslip*** are applicable in the Texas state courts. The Court of Appeals noted that the opportunity for review by a trial court is available by both the trial court and the appellate courts.

The Texas Supreme Court recently addressed the imposition of punitive damages. ***Transportation Ins. Co. v. Moriel***, 37 Tex. Sup. Ct. J. 450 (Feb. 2, 1994). In ***Moriel***, the Texas Supreme Court recognized that *punitive damages* have many of the characteristics and attributes that were the basis for the New York Court of Appeals' decision in ***Garrity v. Lyle Stuart, Inc.***, 353 N.E.2d 793 (1976). The Court noted at several places in its opinion that there is a close connection between punitive damages and the criminal law. *See* ***Moriel***, 37 Tex. Sup. Ct. J. at 454, 457. The Texas Supreme Court also noted in ***Moriel*** that the U.S.

constitution imposes certain limitations on awards of punitive damages. ***Id.*** at 463-465.

In ***Moriel***, the Texas Supreme Court declined to declare unconstitutional or otherwise change the principle that its review of punitive damage awards extends only to determining whether the evidence supporting the award was *legally sufficient*. ***Id.*** at 461.[1/] The Texas Supreme Court in ***Moriel*** held that the evidence presented by Moriel was *legally sufficient* to sustain the judgment that the insurer acted without any reasonable basis in delaying the payment of the claim and thus was liable in tort for breach of the duty of good faith and fair dealing. The Court held, however, that under the clarified definition of *gross negligence*, the insurer cannot be held liable for *punitive damages* unless there is also *legally sufficient* evidence (a) that the defendant's conduct created an *extreme risk of harm*, and (b) that the defendant was consciously indifferent to this *extreme risk of harm* or was actually aware of this *extreme risk of harm*. ***Id.*** at 462.

The Texas Supreme Court in ***Moriel*** expressly stated that because the plaintiff did not present legally sufficient evidence of *gross negligence*, the Constitutional issues (*e.g.*, whether the size of the punitive damages award or whether the procedures followed by the trial court violated the defendant's Due Process rights) remained open questions.

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1/ As will become apparent from the following discussion, the future evolution of the Due Process protections against excessive and inappropriate punitive damage awards by the U.S. Supreme Court may well require a change in the way Texas courts review punitive damage awards.

Nevertheless, in remanding the case for a new trial, the Texas Supreme Court reviewed the Constitutional Due Process analyses in ***Pacific Mutual Life Ins. Co. v. Haslip***, 499 U.S. 1 (1991), and in ***TXO Prod. Corp. v. Alliance Resources Corp.***, 113 S.Ct. 2711 (1993). The Texas Supreme Court also noted that the Supreme Court has now granted writs in still another case, ***Oberg v. Honda Motor Co.***, 851 P.2d 1084 (Or. 1993), *cert. granted*, 62 U.S.L.W. 3470 (U.S. Jan. 14, 1994), involving Due Process limitations on the awards of punitive damages. Although the Texas Supreme Court did not explicitly rule on the Constitutional issues, it is significant that the Court chose to create additional *common law* safeguards.

The Texas Supreme Court in ***Moriel*** first focused on the Texas state court procedures for awarding punitive damages at the trial court level. The Court noted that at the trial court level, the jury instructions used in the trial of the ***Moriel*** case, which appear to have been based upon the Texas pattern jury charge and ***Alamo National Bank v. Kraus***, 616 S.W.2d 908, 910 (Tex. 1981), were more comprehensive than those analyzed by the United States Supreme Court in ***Haslip*** and thus would presumably pass scrutiny under the United States Constitution. 37 Tex. Sup. Ct. J. at 463, n. 21.

Constitutional standards also involve post-verdict procedures for scrutinizing the jury's award of punitive damages. This is clearly so at the Trial Court level. While the Supreme Court indicated in ***Haslip*** and ***TXO*** that such post-verdict procedures *should* also exist at the appellate level, undersigned counsel respectfully predicts that the Supreme Court will hold in ***Oberg*** that such procedures must also exist at the appellate level. In ***Moriel***, the Texas Supreme Court noted that the Supreme Court in ***Haslip*** emphasized a post-verdict procedure where the trial courts are required to scrutinize punitive damage awards, reflecting

on the record their reason for upholding or refusing to uphold the award, ***Moriel***, 37 Tex. Sup. Ct. J. at 463, and also emphasized the fact that the appellate review in Alabama provides an additional check on the jury's or trial court's discretion. ***Id.*** at 463. The Texas Supreme Court observed that, by contrast, in Texas a defendant *may* obtain trial court review of a punitive damage award by filing a motion for new trial, but there is no requirement for the trial courts to scrutinize each award and set forth reasons on the record for refusing to disturb a jury's verdict. ***Id.*** at 464. Indeed, Texas trial courts are not even required to rule on a motion for new trial; they may ignore the motion and passage of time will serve to overrule the new trial motion by operation of law. ***Id.*** at 464.

Moving further up the ladder of post-verdict review, the Texas courts of appeal may overturn the jury's verdict and order the case retried only if the verdict is so against the great weight and preponderance of the evidence as to be manifestly unjust. ***Id.*** at 464. Finally, the Texas Supreme Court, unlike its counterparts in Alabama and West Virginia and most other States, is precluded from reviewing the evidence supporting a punitive damage award for factual sufficiency. ***Id.*** at 464. The Texas Supreme Court in ***Moriel*** concluded that under Texas procedures, the evidence supporting a punitive damage award is scrutinized less closely on appeal than in some other states. ***Id.*** at 464. Indeed, the Court stated that many aspects of the procedures employed up to now by Texas courts do not compare favorably to those examined in ***Haslip*** and ***TXO***. ***Id.*** at 464.

Recognizing, as has New York's highest court in ***Garrity***, the close connection between punitive damages and the criminal law, the Texas Supreme Court stated that punitive damages are proper only in the <u>most</u> <u>exceptional</u> cases and

that the jury discretion which is the hallmark of the common law punitive damage system **must** be complemented by procedural safeguards that will ensure against (i) excessive or (ii) *otherwise inappropriate* awards. (emphasis added.) ***Id.*** at 464-465. The Court concluded that the Texas procedures for assessing and reviewing punitive damage awards, both at the trial and appellate levels, in some respects may not adequately ensure that such awards are not grossly out of proportion of the severity of the offense and have some understandable relationship to compensatory damages. ***Id.*** at 465.

In an effort to address these shortcomings, the Texas Supreme Court articulated procedural standards for the Trial Courts in this State to apply with respect to claims for *punitive damages*. Without reaching the constitutional questions, the Court announced, pursuant to its authority under the common law (the same foundation used by the New York Court of Appeals in ***Garrity*** and other courts[2/]), two changes in the procedures by which punitive damages may be awarded in the Texas state courts. The changes are:

a. The issue as to the amount of punitive damages must be bifurcated from the remaining issues in the trial of the Cause. 37 Tex. Sup. Ct. J. at 465-66. The Court noted that thirteen other States already require bifurcation of trials in which punitive damages are sought. ***Id.*** at 465-

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2/ ***See Shaw v. Kuhnel & Associates, Inc.***, 698 P.2d 880 (N.M. 1985); ***United States Fidelity & Guaranty Co. v. DeFluiter***, 456 N.E.2d 429 (Ind. Ct. App. 1983); ***School City of East Chicago, Indiana v. East Chicago Federation of Teachers***, 422 N.E.2d 656 (Ind. Ct. App. 1981).

66. The Court held the issue is not whether bifurcation is Constitutionally required, but whether the Texas system of imposing punitive damages provides adequate procedural safeguards to protect against awards that are grossly excessive. Concluding that the current procedures are not adequate, the Court adopted the requirement of bifurcated trials in punitive damages cases.

b. The courts of appeal are already obligated, when reversing a jury's award on insufficiency grounds, to detail the evidence in their opinions and explain why the jury's finding is factually insufficient or so against the great weight and preponderance of the evidence as to be manifestly unjust. ***Pool v. Ford Motor Co.***, 715 S.W.2d 629, 635 (Tex. 1986). The Texas Supreme Court in ***Moriel*** extended this obligation. Now, the reviewing courts of appeal are also obligated to detail the evidence in their opinions when they are affirming an award of punitive damages over a challenge that it is based on insufficient evidence or against the great weight and preponderance of the evidence. The Texas Supreme Court held that this procedure will ensure careful appellate review of the punitive award and allow the Texas Supreme Court to determine whether the court of appeals correctly applied the ***Kraus*** factors. 37 Tex. Sup. Ct. J. at 466.

If the U.S. Supreme Court in ***Oberg*** mandates appellate review of a jury's award of punitive damages, additional changes to the Texas procedures may be needed to ensure

against excessive or otherwise inappropriate punitive damage awards.

**3. The safeguards emphasized by the U.S. Supreme Court and the Texas Supreme Court in *TXO*, *Haslip*, and *Moriel* are completely absent from arbitration proceedings:**

There is nothing in an arbitration proceeding to ensure against excessive or otherwise inappropriate punitive damage awards. None of the protections -- not a single one -- discussed by the Supreme Court in ***Haslip*** and ***TXO***, or discussed and required by the Texas Supreme Court in ***Moriel***, is present in an arbitration proceeding. There is no voir dire of the potential arbitrators to determine their biases against the defendant or their feelings as to the award of punitive damages. Discovery is abbreviated, which can result in the defendant being denied the opportunity to develop the facts necessary to refute the plaintiff's allegations. There are few evidentiary rules applicable to an arbitration proceeding; virtually everything is admissible into evidence. Hence, there is no procedure for controlling and limiting the evidence submitted to the Arbitrators and the statements made by the parties and their advocates to the Arbitrators. Virtually anything can be done or said during an arbitration hearing -- and apparently was in this case. Emotional and prejudicial testimony that would never be admitted into evidence by a trial court in a jury trial will usually be considered by arbitrators. There is often no transcript and thus there is no mechanism for the trial court or appellate courts to determine what evidence was considered by the arbitrators.

There is no procedure whereby the arbitrators are provided, either by the Trial Court or the American

Arbitration Association or some other supervising organization, instructions that articulate the purposes of punitive damages. Unlike juries, arbitrators are not instructed that punitive damages are to punish and to deter the defendant, nor are arbitrators instructed as to when and under what circumstances the law allows the award of punitive damages.

Because punitive damages are so subjective, the U.S. and Texas constitutions require supervision by the trial or appellate courts. However, one of the underlying theories of arbitration is that there should be minimal court review and supervision. Because there is rarely a record of the arbitration proceedings, arbitrators sometimes choose not to state their reasoning or the bases for their decision, making it is almost impossible for reviewing courts to supervise the proceedings or the arbitrators' award. While this seems acceptable for compensatory damages, allowing arbitrators to award *punitive* damages will lead to unpredictable, uncontrollable, nonreviewable awards of punitive damages.

There is no procedure applicable to arbitration awards for the trial court or the appellate courts to review the testimony and documents considered by the arbitrators or the basis on which the arbitrators made their award of punitive damages. Similarly, there is no procedure for the trial court or the appellate court to determine whether the award of punitive damages by the arbitrators is excessive taking into account the factors articulated by the Texas Supreme Court: (i) whether the exemplary damages are reasonably proportional to actual damages, (ii) the nature of the wrong, (iii) the character of the conduct involved, (iv) the culpability of the wrongdoer, (v) the situation and sensibilities of the parties, and (vi) the extent to which the wrongful conduct offends a public sense of justice and

propriety. *See, e.g.*, ***Alamo National Bank v. Kraus***, 616 S.W.2d 908, 910 (Tex. 1981).

Perhaps most disturbing of all in this case is the fact that Ms. Kline did not even lodge a claim for punitive damages. The intent of the parties that the arbitrators may not award punitive damages is reflected by the fact that Ms. Kline did not plead for such damages and presented no claim that would support the award of punitive damages. She sought only economic losses for breach of contract. It was only after the close of evidence that Ms. Kline's counsel (obviously believing he had successfully attacked Mr. O'Quinn) asked for such damages. Ms. Kline made this belated request even though Texas law does not allow the recovery of punitive damages under these circumstances. The Arbitrators, completely contrary to the law, awarded such damages. This action by the Arbitrators exceeded their authority. The Trial Court was correct in modifying the Award to vacate the portion thereof where the Arbitrators exceeded their authority.

Arbitration is entirely consensual. Unless there is a *contract* containing an arbitration provision, there is no arbitration. *Contracting* parties elect to submit their future disputes to arbitration for the purpose of a private, speedy and fair resolution, without the delays and rigidities of a court trial. They expect their arbitrators to award the type of relief that the law allows for breach of *contract*. They do not expect the arbitrators to award punitive damages, particularly when the law does not allow the recovery of punitive damages for *breach of contract*.

It is one thing for *contracting* parties to submit to arbitration the issue of *contractual* **compensatory** damages, which are largely based on objective criteria. But **punitive** damages are entirely different. Punitive damages are

subjective and, as the Texas Supreme Court held in ***Moriel***, the jury discretion that is the hallmark of the common law punitive damage system **must** be complemented by procedural safeguards that will ensure against excessive or otherwise inappropriate awards. It is inconceivable, and simply cannot be the case, that when parties submit their *contractual* disputes to arbitration they face the risk of having punitive damages awarded against them in the complete absence of substantive and procedural safeguards to ensure against excessive or otherwise inappropriate punitive damage awards. Parties do not "waive" these significant substantive and procedural rights simply by agreeing that their future *contract* disputes will be resolved by arbitration.

As the New York Court of Appeals recognized in ***Garrity***, arbitrators function in a system completely devoid of any of the safeguards required to ensure against excessive or inappropriate awards of punitive damages. Hence, arbitrators should not be allowed to award punitive damages. Should this Court conclude, however, that the policy and constitutional concerns do not require barring arbitrators completely from awarding punitive damages, those same concerns at the very least require that arbitrators may not award punitive damages except where the contracting parties have expressly granted them the authority to do so. ***See Grissom v. Greener & Sumner Constr. Co.***, 676 S.W.2d 709 (Tex. App.--El Paso 1984, writ ref'd n.r.e.) (affirming arbitration award of punitive damages where the parties expressly agreed to submit this issue to arbitration). A rule disallowing punitive damages in arbitration unless the parties have expressly agreed otherwise is consistent with the constitutional limitations of ***TXO***, ***Haslip***, and ***Moriel***, yet is also consistent with ***Grissom***. It is simply not realistic, and certainly not in the best interest of encouraging arbitration, to assume that when parties agree to arbitrate future

disputes arising out of their contract they thereby "waive" all of the various Constitutional and public policy protections afforded by the law.

In this case, the safeguards imposed by the legal system on the arbitration proceedings simply fail to satisfy the requirements of the Due Process Clause of the Fourteenth Amendment to the United States Constitution and the Due Course of Law provision of the Texas Constitution. As such, the Trial Court's decision to modify the Award to eliminate the punitive damages purportedly imposed on Mr. O'Quinn was correct because the award of punitive damages violated the Due Process Clauses of the United States and Texas Constitutions. Accordingly, Mr. O'Quinn requests that this Court reconsider and rehear its Opinion and, upon reconsideration, affirm the Judgment of the Trial Court.

### C. Arbitrators should not be permitted to award punitive damages as a matter of public policy: (Germane to Point of Error on Rehearing No. 4)

Even if this Court concludes that arbitration proceedings are constitutionally acceptable, this Court should hold that public policy considerations prohibit arbitrators from awarding punitive damages, at least unless the parties have otherwise expressly agreed. In ***Garrity v. Lyle Stuart, Inc.***, 353 N.E.2d 793 (1976), the New York Court of Appeals examined this precise issue. The Court of Appeals held, not on constitutional grounds, but as a matter of public policy, that an arbitrator has no power to award punitive damages, even if the parties had attempted to bestow that power on the arbitrator. The court held that punitive damages is a sanction reserved to the state, a public policy of such magnitude as to call for judicial intrusion to prevent its contravention. ***Id.*** at 794. Because enforcement

of an award of punitive damages as a purely private remedy would violate strong public policy, the New York Court of Appeals held that an arbitrator's award which imposes punitive damages should be vacated. ***Id.*** at 794.

The factors considered by the New York Court of Appeals which constituted the bases for its conclusion were:

> (1) At common law, punitive damages are available only in a limited number of instances. Punitive damages are allowed in cases where the wrong complained of is morally culpable, or is actuated by evil and reprehensible motives, not only to punish the defendant, but to deter him, as well as others who might otherwise be so prompted, from indulging in similar conduct in the future. It is a so-called exemplary "remedy," not a private compensatory remedy. ***Id.*** at 795.
>
> (2) Punitive damages are not available for mere breach of contract, for in such a case, only a private wrong and not a public right is involved. ***Id.*** at 795. Even if there was a so-called "malicious" breach of the contract, that would not permit the imposition of punitive damages. Punitive sanctions are reserved to the State. This is a public policy of such magnitude as to call for judicial intrusion. ***Id.*** at 796.
>
> (3) The evil of permitting an arbitrator, whose selection is often restricted or can be manipulated by the party in a superior bargaining position, to award punitive damages is that it displaces the court and the jury, and therefore the State, as the engine for imposing a social sanction. Actual damages are measurable against some

objective standard. But punitive damages take their shape from the subjective criteria involved in attitudes toward correction and reform, and courts do not readily accept the delegation of that kind of power. Where punitive damages have been allowed for those torts which are still regarded somewhat as public penal wrongs, as well as actionable private wrongs, they have rather close judicial supervision. ***Id.*** at 796.

(4) Standards, such as whether the award of punitive damages was irrational or unjust, are subjective and afford no practical guidelines for the arbitrator and little protection against abuse. Moreover, even if such standards were imposed on the arbitration proceeding in an effort to install fairness to the system, the imposition of the standards would be contrary to the sound development of arbitration law. ***Id.*** at 796.

(5) The parties to arbitration agree to the substitution of a private tribunal for purposes of deciding their disputes without the expense, delay, and rigidities of traditional courts. If arbitrators are allowed to impose punitive damages, the usefulness of arbitration will be destroyed. It will become a trap for the unwary, given the eminently desirable freedom from judicial overview of law and facts. It would mean that the scope of the determination by arbitrators, by the license to award punitive damages, would be both unpredictable and uncontrollable. ***Id.*** at 796.

(6) In imposing penal sanctions in private arrangements, a tradition of the rule of law in organized society is violated. One purpose of

> the rule of law is to require that the use of coercion be controlled by the State. In a highly developed commercial and economic society, the use of private force is not the danger, but the uncontrolled use of coercive economic sanctions in private arrangements is. The power to punish is a monopoly of the State and not that of any private individual. ***Id.*** at 796-797.
>
> (7) The parties usually never agreed, or, for that matter, even consider punitive damages as a possible sanction for breach of an agreement. Even if the parties had sought to agree that the arbitrators could award punitive damages, the law does not and should not permit private persons to submit themselves to punitive sanctions of the order reserved to the State. The freedom of contract does not embrace the freedom to punish, even by contract. ***Id.*** at 797.
>
> (8) Under common law principles, there is eventual supervision of jury awards of punitive damages, in the singularly rare cases where they are permitted, by the trial court's power to change awards and by the appellate court's power to modify such awards.

Other states have adopted this same holding for public policy reasons. For example, in ***Shaw v. Kuhnel & Associates, Inc.***, 698 P.2d 880, 881 (N.M. 1985), the Supreme Court of New Mexico held, citing ***Garrity***, that an Arbitrator should not be given authority to award punitive damages; this power is reserved to the Courts. In ***United States Fidelity & Guaranty Co. v. DeFluiter***, 456 N.E.2d 429 (Ind. Ct. App. 1983), the Indiana Court of Appeals held that because arbitration arises out of a contractual relationship, punitive

damages are unavailable because parties may not contract to benefit from or be penalized by punitive damages. ***Id.*** at 432. ***See also, School City of East Chicago, Indiana v. East Chicago Federation of Teachers***, 422 N.E.2d 656, 663 (Ind. Ct. App. 1981).

The Trial Court's decision to modify the Award to eliminate the punitive damages purportedly imposed on Mr. O'Quinn was correct because the award of punitive damages violates important public policy concerns of the State of Texas. The policy concerns recognized by New York's highest court are just as true in Texas as they are in New York. Just as the New York Court of Appeals recognized, parties agree to arbitration for purposes of deciding their disputes without the expense, delay, and rigidities of traditional courts. If arbitrators are allowed to impose punitive damages, the usefulness of arbitration will be destroyed. It will mean, just as the New York Court of Appeals predicted, that the scope of the determination by arbitrators, by virtue of the license to award punitive damages, will become unpredictable and uncontrollable. Indeed, if arbitrators can award punitive damages without being subjected to even the controls required for a jury to award punitive damages, and without the trial court and appellate court review required with respect to jury awards, contracting parties will seek to avoid arbitration. On the other hand, if as a matter of public policy Arbitrators are not allowed to award punitive damages, arbitration will become an even more effective and favored means for resolving disputes between contracting parties.

**II. This Court erred in holding that the parties submitted the issue of punitive damages to arbitration: (Germane to Point of Error on Rehearing Nos. 1, 5, 7 & 8)**

**A. Arbitrators must act within the limitations imposed by the parties' agreement and the law:**

All arbitration proceedings in this State, whether conducted pursuant to the common law, the Texas General Arbitration Act, or the Federal Arbitration Act, arise out of consensual understandings. Article 224 of the Texas General Arbitration Act makes it clear that a written agreement is required to compel parties to arbitrate their disputes and the terms of the written agreement govern which disputes are submitted to arbitration. TEX. REV. CIV. STAT. ANN. art 224 (Vernon Supp. 1993). Because arbitration provisions are in derogation of a right of trial by jury, arbitration is not extended beyond the terms of the contract or to issues and matters not covered thereby. *See, e.g.,* ***Seale v. Roy M. Mitchell Contracting Co.***, 321 S.W.2d 149, 150 (Tex. Civ. App.--Austin 1959, writ ref'd). Texas courts consistently hold that the parties must have *specifically agreed* to arbitrate the particular matter in dispute. *See, e.g.,* ***Valero Energy Corp. v. Wagner & Brown***, 777 S.W.2d 564, 566 (Tex. App.--El Paso 1989, writ denied). Similarly, the United States Supreme Court has admonished that "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed to submit." ***United Steelworkers v. Warrior & Gulf Navigation Co.***, 363 U.S. 574, 582 (1960).

Although it is often assumed that an arbitration award is entitled to great deference by the courts, this assumption is untrue with respect to the authority and jurisdiction of the arbitrators. An arbitrator's decision as to the scope of his

authority is subject to the scrutiny of the courts to ensure that the arbitrator acted properly. ***E.g., E. I. Du Pont de Nemours & Co. v. Local 900***, 968 F.2d 456, 458 (5th Cir. 1992); ***Babcock & Wilcox Co. v. PMAC, Ltd.***, 863 S.W.2d 225, 230 (Tex. App.--Houston [14th Dist.] 1993, writ requested).

The Texas General Arbitration Act provides for the determination of whether the arbitrators exceeded their authority or awarded on a matter not submitted, at least to the extent of determining whether the arbitrators acted within the bounds of their authority. Article 237 requires that an award be vacated when the arbitrators exceed their authority and Article 238 requires the modification or correction of an award when the arbitrators make an award on a matter not submitted to them. TEX. REV. CIV. STAT. ANN. arts. 237 & 238 (Vernon 1973). Review of the award is so important that, even where the parties expressly waive the right to judicial review of an arbitration award, the courts still have the authority to review the award under Articles 237 and 238. ***Grissom v. Greener & Sumner Constr., Inc.***, 676 S.W.2d 709, 711 (Tex. App.-- El Paso 1984, writ ref'd n.r.e.).

**B. This Court's Opinion incorrectly addresses the arbitrators' authority on *procedural* questions instead of reviewing the award pursuant to Articles 237 and 238:**

As noted, Articles 237 and 238 require the Texas courts to review arbitration awards if the review is timely requested. TEX. REV. CIV. STAT. ANN. arts. 237 & 238. Various grounds for review are specified in Articles 237 and 238. Mr. O'Quinn timely requested review of the award.

Despite the plain wording of Articles 237 and 238, this Court's Opinion essentially ignores the relevance of Ms. Kline's submissions to the arbitrators. *See* Op. at 8-10. In fact, Ms. Kline's demand for arbitration and other papers submitted to the arbitrators are the most important record of which issues were submitted to arbitration. ***See USX Corp v. West***, 781 S.W.2d 453 (Tex. App. -- Houston [1st Dist.] 1989, no writ) (considering pleadings and submissions to arbitrators). As detailed below, Ms. Kline never submitted the question of punitive damages to arbitration. Under Article 238(A)(2), the Trial Court was therefore required to modify the award to delete the award of punitive damages.

In its opinion, this Court cites ***USX***, ***John Wiley & Sons, Inc. v. Livingston***, 376 U.S. 543 (1964), and ***Del E. Webb Constr. v. Richardson Hosp. Auth.***, 823 F.2d 145 (5th Cir. 1987), for the proposition that procedural questions involving a dispute in arbitration should be left to the arbitrators. The "procedural questions" at issue in ***John Wiley*** and ***Del Webb***, however, dealt only with the procedures the parties were required to follow prior to invoking arbitration. In ***John Wiley***, the Court considered an agreement that required (1) a conference among an employee, a union representative, and an officer of the employer and (2) a conference among an officer of the employer, the union shop committee and/or a union representative *before* the parties initiated arbitration. 376 U.S. at 555-56. Similarly, ***Del Webb*** involved "contractual prerequisites for demanding arbitration," although the Fifth Circuit did not state just what these were. *See* 823 F.2d at 146 & 149-150.

In the arbitration clause at issue here, the parties were to "endeavor in good faith to resolve the dispute amicably" before resorting to arbitration. *See* Op. at 7. Whether or not they met this requirement would be a "procedural

question" for the arbitrators under ***John Wiley*** and ***Del Webb***. However, that question is not at issue in this case. Instead of such a "procedural question," this case involves the scope of the arbitrators' authority and whether punitive damages were submitted to the arbitrators.

A close reading of ***USX*** shows that it is consistent with Mr. O'Quinn's position. As detailed below, ***USX*** dealt primarily with the question of whether a trial court was required to *compel* arbitration after it had already stayed the case pending arbitration. *See* 781 S.W.2d at 454-56. In ***USX***, Energy Buyers filed suit, claiming both actual damages and punitive damages. ***Id.*** at 454 & 456. Unlike Ms. Kline, Energy Buyers clearly requested punitive damages. Moreover, Energy Buyers requested "damages" in its answer filed with the arbitrators. ***Id.*** at 455. With respect to the question of whether Energy Buyer's papers were sufficient or a clearer statement was required, the court observed that such matters were for the arbitrators. ***Id.*** at 456.

Unlike ***USX***, Ms. Kline's court pleadings failed to request punitive damages. Hence, there was no potential conflict between what Ms. Kline sought from the court versus the arbitration, as was the case in ***USX***. Moreover, Ms. Kline submitted her court pleadings to the Arbitrators to make it clear that she was seeking exactly the same relief in arbitration that she had requested from the court. Accordingly, the discussion in ***USX*** about procedural questions does not apply to Ms. Kline's submissions to the arbitrators. Ms. Kline's submissions to the arbitrators made it quite clear that she was seeking actual damages, <u>not</u> punitive damages.

**C. Ms. Kline's own pleadings and demand for arbitration show that she did not**

**submit the issue of punitive damages to the arbitrators:**

Due process of law applies in arbitration proceedings just as in other legal proceedings. This means that parties are entitled to fair notice of the claims made against them. This Court erred by failing to hold that the claims that Ms. Kline presented to the arbitrators were defined by her Plaintiff's Original Petition. By letter of May 28, 1991 from Ms. Kline's counsel to Ms. Tamme S. Wilkes of the American Arbitration Association, Ms. Kline's counsel transmitted the Original Petition to the American Arbitration Association as the definition of Ms. Kline's claim. In her Original Petition, Ms. Kline alleged breach of contract, breach of an alleged tort duty of good faith, and breach of an alleged fiduciary duty. Ms. Kline pled and prayed only for actual damages, *i.e.*, economic losses. Ms. Kline did not plead or pray for exemplary damages. Indeed, there is no mention -- not one single word -- in the Original Petition about exemplary damages.

In this case there was no pleading or prayer -- no notice whatsoever -- that Ms. Kline was asking for punitive damages. Moreover, Ms. Kline did not plead the existence of a separate and distinct tort that caused separate actual damages in tort. Each of these elements is required by Texas law before a claimant can recover punitive damages. Lawyers who are trained to recognize the necessary elements of a claim for punitive damages simply could not have known from Ms. Kline's pleadings that she was thinking about attempting to recover punitive damages. The law does not require them to guess as what Ms. Kline might be secretly planning.

This Court incorrectly ignored Ms. Kline's own submissions to the arbitrators. On page 10 of its Opinion, the Court suggests that Ms. Kline's submission to the arbitrators constitutes "extrinsic evidence" which need not be considered. The Texas General Arbitration Act, however, requires the courts to modify or correct an award if the arbitrators issue an award on "a matter not submitted to them..." TEX. REV. CIV. STAT. ANN. art. 238(A)(2). Moreover, both this Court and the Texas Supreme Court have considered such "extrinsic" matters in determining the scope of the matters submitted to arbitration. ***See USX Corp. v. West***, 781 S.W.2d 453, 455 (Tex. App.--Houston [1st Dist.] 1989, no writ) (considering papers submitted to the American Arbitration Association); ***Gulf Oil Corp. v. Guidry***, 327 S.W.2d 406, 407-11 (Tex. 1959) (considering various papers and correspondence among the arbitrators). Hence, Ms. Kline's statement of her claims via her submissions to the arbitrators is extremely important.

The Trial Court found that the issue of punitive damages was not submitted to the arbitrators. Both ***USX*** and ***Gulf Oil*** make it clear that the Trial Court properly considered Ms. Kline's submissions to the AAA. In the absence of a transcript of the arbitration proceedings, this Court should defer to the Trial Court on the question of whether, despite Ms. Kline's submissions, the parties nonetheless submitted the issue of punitive damages to arbitration. Despite the Court's statement to the contrary, it need not follow ***House Grain Co. v. Obst***, 659 S.W.2d 903, 906 (Tex App.--Corpus Christi 1983, writ ref'd n.r.e.), and "presume adequate evidence to support the award." As pointed out in Justice Ellis' dissent, ***Obst*** created this supposed presumption without any supporting authority from the Texas Supreme Court. Moreover, ***Gulf Oil*** suggests that the Texas courts should consider various papers, including correspondence, to determine whether a particular

issue was submitted to arbitration and whether the arbitrators exceeded their authority. ***Gulf Oil***, 327 S.W.2d at 407-11.

Finally, it is important to note that the appellant generally bears the risk of having an inadequate record. *See* ***Christiansen v. Prezelski***, 782 S.W.2d 842, 843 (Tex. 1990); TEX. R. APP. P. 50(d). Hence, if an appellant (such as Ms. Kline) fails to present a complete statement of the facts, the appellate court cannot properly determine that the Trial Court's ruling was incorrect. *See Christiansen*, 782 S.W.2d at 843-44. In the past, this Court has emphasized that the appellant, not the appellee, bears the burden of submitting an adequate record to reverse the trial court's handling of an arbitration award. ***Atrium Westwood VIII Venture v. Barrick Westwood L.P.***, 693 S.W.2d 699, 700-01 (Tex. App.--Houston [14th Dist.] 1985, no writ). Accordingly, this Court's presumption of evidence to support the award, a presumption which runs contrary to Ms. Kline's own submission to the AAA and this Court's decision in ***Westwood***, is in error. Instead, the Court should rely on Ms. Kline's submissions to the arbitrators and defer to the Trial Court's findings.

**D. The parties' agreement precluded the submission of the question of punitive damages:**

The dispute submitted to the arbitrators arose out on a written agreement among Ms. Kline, Mr. O'Quinn and Mr. Pearson relating to the apportionment of legal fees received from several cases. In this agreement, there was an arbitration provision which provides as follows:

> In the event that a dispute arises among Parties that cannot be amicably resolved or, Parties have elected to terminate this Agreement and are unable to reach an agreement to that end, said dispute shall be determined by arbitration conducted in the City of Houston, State of Texas, in accordance with the rules then in force of the American Arbitration Association. [Tr. 34]

By this agreement, Mr. O'Quinn, Ms. Kline and Mr. Pearson did not expressly, or even by implication, grant authority to the Arbitrators to award exemplary damages in connection with disputes arising out of an alleged breach of the contract in dispute.

This arbitration provision is fairly narrow -- it avoids the broad terminology frequently found in arbitration provisions that the parties submit "any and all claims, demands, disputes, controversies, or other matters pertaining to the written agreement in issue, whether or not arising independently out of the written agreement, and whether in contract, tort or otherwise." *See* ***Babcock & Wilcox***, 863 S.W.2d at 230 (listing several examples of broad arbitration clauses, each of which starts with "any dispute" or the like). The use of the narrow arbitration provision in the agreement among Ms. Kline, Mr. O'Quinn, and Mr. Pearson

thus demonstrates that the parties intended for the arbitrators to resolve contractual disputes, not to award exemplary damages for alleged activities outside the scope of the contract.

Despite the Court's view that the arbitration clause is broad, it is quite similar to the one at issue in ***Central Texas Clarklift, Inc. v. Simmons***, 540 S.W.2d 745, 746-47 (Tex. Civ. App.--Waco 1976, no writ). That case involved the following arbitration clause:

> Upon the occurrence of a dispute relative to any provision of this Agreement or the application of any provision of this Agreement or if a price determination is required by any Paragraph herein, the same shall be submitted to arbitration under the terms and conditions of the "Texas General Arbitration Act."

540 S.W.2d at 746. In ***Simmons***, the plaintiff had sold a business. As part of the sale contract, Mr. Simmons also agreed to a covenant not to compete. When the buyer learned of Mr. Simmons' new employment with Trans Lift, the buyer sent letters and made telephone calls to Trans Lift asserting that Mr. Simmons was violating the covenant not to compete. 540 S.W.2d at 746. Mr. Simmons sued the buyer for tortious interference. The court of appeals held that the claim for tortious interference was not within the scope of the above arbitration clause, as the alleged intentional tort was not a dispute relating to the contract. ***Id.*** at 747.

The arbitration provision in the contract among Ms. Kline, Mr. O'Quinn and Mr. Pearson was clearly no broader than that at issue in ***Simmons***. Moreover, the arbitration clause in this case clearly did not authorize the

arbitrators to award punitive damages for activities for which punitive damages may not be awarded under Texas law, *i.e.*, for breach of contract. In this case, as discussed below, the only alleged activities that could have possibly given rise to punitive damages would have been activities outside the agreement. As in ***Simmons***, the arbitration provision between Mr. O'Quinn and Ms. Kline did not specifically authorize the arbitrators to award punitive damages for outside-the-contract activities. Because of the unique and harsh nature of punitive damages, it is inappropriate to assume that the parties intended the arbitration provision to authorize the arbitrators to award punitive damages for outside-the-contract activities.

While the issue is not settled in Texas, the El Paso Court of Appeals has held that the arbitrators have the power to award punitive damages -- where the parties have ***expressly*** submitted the issue to the arbitrators. ***Grissom v. Greener & Sumner Constr., Inc.***, 676 S.W.2d 709, 711 (Tex. App. -- El Paso 1984, writ ref'd n.r.e.). But the ***Grissom*** decision is not applicable here because the parties here did not expressly submit the issue to the arbitrators. It is respectfully that, as a matter of law, arbitrators should not be allowed to award punitive damages unless the parties have specifically and expressly granted that authority to the arbitrators.

In its Opinion, this Court relied heavily on ***USX Corp. v. West***, 781 S.W.2d 453 (Tex. App. -- Houston [1st Dist.] 1989, no writ). In ***USX***, this Court refused to mandamus Judge David West to require him to grant a motion to compel arbitration because he had already granted a motion to stay pending arbitration. ***USX***, 781 S.W.2d at 454-56. In effect, the court reviewed the pleadings and submissions to the arbitrators, concluding that they were sufficient to submit various contract and tort claims, and various types of

damages, to the arbitrator. The court then left it to the parties and the arbitrator to address pleading issues. ***Id.*** at 456-57.

Significantly, however, the ***USX*** case did not address the basic question of whether an award of punitive damages is constitutional or otherwise prohibited by public policy. Moreover, the ***USX*** case did not address questions involving the determination of what was submitted to arbitration; instead ***USX*** involved what should be submitted. Deference in favor of arbitration at the early stages of a dispute makes sense, as it seems likely to further the use of arbitration. After an arbitration proceeding is concluded, however, the Texas General Arbitration Act requires the consideration of what was submitted and whether the arbitrators exceeded their authority.

**E. The Trial Court's Judgment Should be Affirmed because the arbitrators exceeded their authority:**

The Court incorrectly avoided the issue of whether the arbitrators exceeded the scope of their authority. *See* Op. at 6. Instead of addressing this alternative basis for affirming the Trial Court, the Court observed that the Trial Court only modified the award, implying that the Trial Court's finding that the arbitrators exceeded their authority is irrelevant. In fact, this finding (which is not rejected by the Court) means that the Judgment should be affirmed.

As this Court correctly notes, Article 237 provides for vacating an award when the arbitrators exceed their authority. Article 238 provides for modification and correction when the arbitrators have awarded on a matter not submitted to them. *See* TEX. REV. CIV. STAT. ANN. art. 237 & 238. Nonetheless, there will be few, if any, cases

where the arbitrators may award on a matter not submitted, yet still act within their authority. This is because all arbitration derives its authority from the parties' agreement. Consequently, there is a great deal of overlap between Articles 237 and 238 -- they are not mutually exclusive, as the Court suggests.

The Texas courts may modify a part of an award if that portion is outside the arbitrators' authority. In ***Smith v. Barnett***, 373 S.W.2d 762, 765-66 (Tex. Civ. App. -- Dallas 1963, no writ), the court modified an award to delete an incorrect amount of interest. The court viewed the mistake as not due to the arbitrators, yet held that even if the arbitrators exceeded their authority, the incorrect amount "could be disregarded as mere surplusage, and the remainder of the award left standing." ***Id.*** at 766. As in ***Smith***, this Court should have affirmed the Trial Court's Judgment to delete the portion of the award which exceeded the arbitrators' authority. Hence, this Court erred when it reversed the Trial Court's Judgment setting aside the punitive damages portion of the award.

**III. Ms. Kline was not entitled to punitive damages:**

This case illustrates a key problem with arbitration -- The arbitrators may, either inadvertently or intentionally, enter an award clearly contrary to the law, yet that award might be upheld. Even this Court hold that Mr. O'Quinn owed no fiduciary duty to Ms. Kline. Moreover, Justice Ellis clearly points out that Mr. O'Quinn owed no tort duty of good faith and fair dealing. The only other claim submitted to arbitration was Ms. Kline's contract claim. As detailed below, Texas law clearly prohibits an award of punitive damages for mere breach of contract. But that is exactly the result of the Opinion.

**A. Under Texas law, there are special rules applicable to punitive damages:**

In addition to failing to plead and pray for exemplary damages and thus failing to submit the issue of punitive damages to the arbitrators, there is another, perhaps even more important, reason why Ms. Kline as a matter of law may not be awarded exemplary damages. Texas law simply does not allow the recovery of punitive damages for breach of contract, even if the breach is intentional, willful, and malicious. *See, e.g., **Manges v. Guerra***, 673 S.W.2d 180, 184 (Tex. 1984); ***Amoco Prod. Co. v. Alexander***, 622 S.W.2d 563, 571 (Tex. 1981). Because plaintiffs continually attempt to side-step this rule by clever pleading, the Texas Supreme Court has established the rule that a complainant's ability in Texas to recover exemplary damages in connection with a breach of contract claim is subject to special rules and requirements. The Texas Supreme Court has held that in order to recover punitive damages attendant to a contract dispute a claimant must both (1) plead and (2) prove: (a) the commission of a separate tort, and (b) **that the claimant**

**sustained separate actual damages as a result of that separate tort**. See, e.g., ***International Bank, N.A. v. Morales***, 736 S.W.2d 622, 624 (Tex. 1987); ***Texas Nat'l Bank v. Karnes***, 717 S.W.2d 901, 903 (Tex. 1986); ***Jim Walter Homes, Inc. v. Reed***, 711 S.W.2d 617, 618 (Tex. 1986); ***Bellefonte Underwriter's Ins. Co. v. Brown***, 704 S.W.2d 742, 745 (Tex. 1986).

Simply alleging, as Ms. Kline did, that the defaulting party to a contract allegedly also breached some tort duty, *e.g.*, fiduciary duties or an implied duty of good faith and fair dealing, will not suffice. There must also be pleading and proof that the separate and distinct tortious conduct caused the claimant to sustain separate and distinct actual damages in tort. It is only the separate actual damages in tort that will support a claim for exemplary damages! *See, e.g.*, ***International Bank***, 736 S.W.2d at 624; ***Texas Nat'l Bank***, 717 S.W.2d at 903; ***Jim Walter Homes***, 711 S.W.2d at 618; ***Bellefonte Underwriter's Ins. Co.***, 704 S.W.2d at 745.

In a further attempt to side-step these requirements, plaintiffs frequently argue that their economic losses in fact are their required "tort" damages. The Texas Supreme Court has rejected this argument. The Court has established the doctrine that if the actual damages sustained by the claimant are economic losses arising out of breach of the contract involved in the litigation, then no matter how the complainant disguises or characterizes her so-called tort claims, the dispute is simply one of breach of contract. *See, e.g.*, ***Crim Truck & Tractor Co. v. Navistar***, 823 S.W.2d 591, 594-95 (Tex. 1992); ***Southwestern Bell Telephone Co. v. FDP Corp.***, 811 S.W. 2d 572, 577 (Tex. 1991); ***Southwestern Bell Telephone Co. v. Delaney***, 809 S.W.2d 493, 495 (Tex. 1991); ***International Bank***, 736 S.W.2d at 624; ***Texas Nat'l Bank***, 717 S.W.2d at 903; ***Jim Walter Homes***, 711 S.W.2d at 618; ***Bellefonte Underwriter's Ins. Co.***, 704 S.W.2d at 745; and ***Amoco Prod. Co.***, 622 S.W.2d at 571.

In this case, there was no pleading of separate tortious conduct by Mr. O'Quinn that caused separate actual damages in tort to Ms. Kline. Ms. Kline alleged that she sustained economic losses resulting from alleged breach of contract. Ms. Kline claimed she was entitled to monies owed to her under the contract, plus interest. The Award of actual damages made her whole. But then Ms. Kline presented the conclusory rhetoric commonly found in pleadings of this nature, the rhetoric which the Texas Supreme Court has consistently held gives rise only to a claim for breach of contract. Ms. Kline made the conclusory allegations that Mr. O'Quinn breached an alleged duty of good faith and breached an alleged fiduciary duty. But, even if such allegations were true, which is denied, Ms. Kline did not plead and prove <u>any separate actual damages in tort</u> (*e.g.*, mental anguish, etc.) caused by the alleged tortious conduct. Thus, while these other extraneous allegations may sound bad (in fact, that is why plaintiffs usually add them into their petition when suing on a contract), they do not convert the case into a tort dispute and they will not support an award of punitive damages.[3/]

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3/ In most situations where a plaintiff is suing on a contract and is also attempting to recover exemplary damages, the plaintiff at least pleads that he or she is seeking exemplary damages. This at least gives the defendant fair notice of the plaintiff's intentions. But here Ms. Kline not only failed to plead and prove separate actual damages in tort to support an award of exemplary damages -- but did not even plead or pray for exemplary damages at all!

Unfortunately, there is no transcript of the arbitration proceeding. Hence, this Court must rely on the pleadings and other submissions in order to determine what was submitted to the arbitrators. Although Ms. Kline suggests that it is somehow Mr. O'Quinn's fault that there is no transcript, Ms. Kline also failed to seek a transcript. As detailed above, the Trial Court properly relied on Ms. Kline's submissions to the AAA to define her claims.

**B. Ms. Kline also failed to plead and prove the type of intentional conduct necessary to support an award of punitive damages:**

Assuming that Ms. Kline had actually pled and proved separate actual damages in tort sustained as a result of breach of an alleged duty of good faith and fair dealing and/or an alleged fiduciary duty, she still would not be entitled to punitive damages. A breach of the duty of good faith and fair dealing by itself does not entitle the injured party to punitive damages. A breach of a fiduciary duty by itself does not entitle the injured party to punitive damages. In order to recover exemplary damages for breach of the duty of good faith and fair dealing or breach of fiduciary duty, a complainant must also plead and prove and obtain the additional finding of fraud, malice, or gross negligence. *See* TEX. CIV. PRAC. & REM. CODE § 41.003 (Vernon Supp. 1993); ***Burk Royalty Co. v. Walls***, 616 S.W.2d 911, 922 (Tex. 1981) (addressing the issue of exemplary damages in general); ***Arnold v. Nat. County Mutual Fire Ins. Co.***, 725 S.W.2d 165, 168 (Tex. 1987) (addressing the issue of exemplary damages in connection with claim of a breach of a duty of good faith and fair dealing); ***Manges v. Guerra***, 673 S.W.2d 180, 184 (Tex. 1984) (addressing the issue of exemplary damages in connection with a claim of breach of fiduciary duty). Because Ms. Kline did not plead or prove

this additional element, she was never entitled to an award of exemplary damages for breach of the alleged torts of good faith and fair dealing and/or fiduciary duty. Hence, the Final Judgment should be affirmed.

**IV. Conclusions:**

Because one of the underlying theories of arbitration is that there should be minimal court review and supervision, allowing arbitrators to award punitive damages will lead to unpredictable, uncontrolled, and nonreviewable awards of punitive damages. This violates public policy concerns of the State and fails to comply with the requirements of the United States and Texas Constitutions. Should this Court conclude that policy and constitutional concerns do not require barring arbitrators completely from awarding punitive damages, those same concerns require that at the very least arbitrators may not award punitive damages except where the contracting parties have expressly granted them the authority to do so. Here the narrowly drawn contractual arbitration provision did not authorize the arbitrators to award punitive damages. This Court did not address the Constitutional issues at all on the basis that Mr. O'Quinn waived these issues. However, the rule cited by this Court for the waiver principle is applicable only to appellants, not appellees. The Texas Supreme Court has repeatedly held that an appellee satisfied with the judgment below does not have to urge below additional grounds in support of the judgment. The appellee is free to raise these additional issues on appeal, which Mr. O'Quinn has done. Mr. O'Quinn is entitled to his day in court before this Honorable Court with respect to the Constitutional issues.

Moreover, this is a case in which the claimant did not properly lodge a claim for punitive damages. Ms. Kline's failure to request punitive damages in her pleadings

demonstrates that the parties never intended to allow the arbitrators to award punitive damages. She sought only economic losses for breach of contract. It was only after the close of evidence that Ms. Kline's counsel (obviously believing he had successfully attacked Mr. O'Quinn) asked for such damages. Ms. Kline made this belated request even though Texas law does not allow the recovery of punitive damages under these circumstances. The Arbitrators, completely contrary to well-settled Texas law, nevertheless awarded such damages. This action by the Arbitrators exceeded their authority. It is respectfully submitted that the Trial Court was correct in modifying the Award to vacate the portion thereof where the Arbitrators exceeded their authority.

Mr. O'Quinn respectfully urges that the Court reconsider its Opinion of March 24, 1994, and upon rehearing modify that decision and instead affirm the Trial Court's *Final Judgment*.

Respectfully submitted,

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JOHN M. O'QUINN

## CERTIFICATE OF SERVICE

I hereby certify that a copy of this MOTION FOR REHEARING OF APPELLEE JOHN M. O'QUINN was served upon each of Donna C. Kline, Thomas J. Pearson, and Bank One, Texas, N.A., by mailing a copy of same via certified mail, return receipt requested, to their respective counsel of record as follows:

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This 8th day of April, 1994.

/s/ J. Clark Martin

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**APPENDIX M**

**NO. _____**

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**JOHN M. O'QUINN,**
**Petitioner,**

**vs.**

**DONNA C. KLINE,**
**Respondent**

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**IN THE TEXAS SUPREME COURT**

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**APPLICATION FOR WRIT OF ERROR OF PETITIONER JOHN M. O'QUINN**

---

**J. Clark Martin**
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TO THE SUPREME COURT OF TEXAS:

COMES NOW Petitioner John M. O'Quinn ("O'Quinn") and respectfully files this Application for Writ of Error. For the reasons set forth below, O'Quinn prays that this Court grant the Application for Writ and ***reverse*** the decision of the Court of Appeals and ***affirm*** the Final Judgment of the Trial Court.

## NAMES OF ALL PARTIES

| | |
|---|---|
| Petitioner: | John M. O'Quinn |
| Petitioner's Counsel: | J. Clark Martin<br>Steven R. Borgman<br>Vinson & Elkins L.L.P. |
| Respondent: | Donna C. Kline |
| Respondent's Counsel: | Norman Riedmueller<br>Michael Pullara |
| Appellee: | Thomas J. Pearson |
| Appellee's Counsel: | Thomas J. Pearson & Associates<br>Pro se |
| Appellee: | Bank One, Texas, N.A. |
| Appellee's Counsel: | Cheryl E. Irvin<br>Irvin, Clark & Burnett |

## TABLE OF CONTENTS:

**NAMES OF ALL PARTIES** ..... i

**TABLE OF CONTENTS** ..... ii

**TABLE OF AUTHORITIES** ..... iv

**STATEMENT OF THE CASE** ..... 1

**STATEMENT OF JURISDICTION** ..... 5

**POINTS OF ERROR** ..... 5

**BRIEF OF THE ARGUMENT** ..... 8

**I. This case involves important issues regarding punitive damages:** ..... 8

**II. Arbitrators generally should not be allowed to award punitive damages: (Germane to Point of Error Nos. 1, 3 & 4)** ..... 9

**A. O'Quinn never waived his constitutional rights or the constitutional arguments against allowing arbitrators to award punitive damages: (Germane to Point of Error No. 2)** 9

**B. Because arbitration proceedings fail to meet the constitutional requirements applicable to punitive damages, arbitrators should not be permitted to award punitive damages: (Germane to Point of Error No. 3)** ..... 11

**1. The U.S. Supreme Court's decisions in *Oberg*, *Haslip* and *TXO* demonstrate the constitutional requirements applicable to awards of punitive damages:** ..... 11

2. **The Texas Supreme Court's decision in *Moriel* also demonstrates the importance of safeguards on awards of punitive damages: . . . . . 15**

3. **The safeguards emphasized by the U.S. Supreme Court and the Texas Supreme Court in *Oberg*, *TXO*, *Haslip*, and *Moriel* are completely absent from arbitration proceedings generally: . . 19**

4. The arbitration proceedings at issue in this case were even worse than usual in terms of the absence of Due Process safeguards against punitive damages ..... 21

5. Contracting parties do not waive their Due Process rights with respect to punitive damages simply by agreeing to arbitrate -- unless they expressly agree to allow arbitrators to award punitive damages: ..... 23

C. Arbitrators should not be permitted to award punitive damages as a matter of public policy: (Germane to Point of Error No. 4) ..... 28

III. The Court of Appeals erred in holding that the arbitrators were authorized to award punitive damages: (Germane to Point of Error Nos. 1, 5, 7 & 8) ..... 32

A. Arbitrators must act within the limitations imposed by the parties' agreement and the law: ..... 32

B. Kline's own pleadings and demand for arbitration show that she did not submit the issue of punitive damages to the arbitrators: 33

C. The parties' agreement precluded the submission of the question of punitive damages: ..... 35

D. The Trial Court's judgment should be affirmed because the arbitrators exceeded their authority and awarded on a matter not submitted: ..... 38

E. **The Fourteenth Court's Opinion incorrectly addressed the arbitrators' authority on *procedural* questions instead of reviewing the award pursuant to Articles 237 and 238:** .. 39

IV. **Kline was never entitled to punitive damages:** .... 41

A. **Under Texas law, there are special rules applicable to punitive damages:** ..... 41

B. **Kline also failed to plead and prove the type of intentional conduct necessary to support an award of punitive damages:** ..... 43

V. **Conclusions:** ..... 44

**TABLE OF AUTHORITIES:**

**CASES:**

*Alamo National Bank v. Kraus*,
616 S.W.2d 908 (Tex. 1981) ..... 15, 17, 19

*Amoco Prod. Co. v. Alexander*,
622 S.W.2d 563 (Tex. 1981) ..... 40, 41

*Arnold v. Nat'l County Mutual Fire Ins. Co.*,
725 S.W.2d 165 (Tex. 1987) ..... 42

*Atrium Westwood VIII Venture v. Barrick Westwood L.P.*,
693 S.W.2d 699 (Tex. App.--Houston [14th Dist.] 1985, no writ) ..... 33

*Babcock & Wilcox Co. v. PMAC, Ltd.*, 863 S.W.2d 225
(Tex. App.--Houston [14th Dist.] 1993, writ pending) 31, 34

*Baltimore Regional Joint Bd. v. Webster Clothes, Inc.*,
596 F.2d 95 (4th Cir. 1979) ..... 25

*Bellefonte Underwriter's Ins. Co. v. Brown*,

704 S.W.2d 742 (Tex. 1986) ..... 40, 41

***Boyce Iron Works, Inc. v. Southwestern Bell Tel. Co.***,
747 S.W.2d 785 (1988) ..... 8, 9

***Browning-Ferris Indus., Inc. v. Lieck***, 845 S.W.2d 926
(Tex. App.--Corpus Christi 1993, writ granted) ..... 13

***Burk Royalty Co. v. Walls***, 616 S.W.2d 911 (Tex. 1981) ... 42

***Central Texas Clarklift, Inc. v. Simmons***,
540 S.W.2d 745 (Tex. Civ. App.--Waco 1976, no writ) ... 35

***Christiansen v. Prezelski***, 782 S.W.2d 842 (Tex. 1990) .... 33

***Complete Interiors, Inc. v. Behan***, 558 So.2d 48,
(Fla. Dist. Ct. App. 1990) ..... 25

***Crim Truck & Tractor Co. v. Navistar***,
823 S.W.2d 591 (Tex. 1992) ..... 41

***Del E. Webb Constr. v. Richardson Hosp. Auth.***,
823 F.2d 145 (5th Cir. 1987) ..... 38, 39

***Dresser Ind., Inc. v. Page Petroleum, Inc.***,
853 S.W.2d 505 (Tex. 1993) ..... 24

***E. I. Du Pont de Nemours & Co. v. Local 900***,
968 F.2d 456 (5th Cir. 1992) ..... 31

***Edward Elec. Co. v. Automation, Inc.***,
593 N.E.2d 833 (Ill. App. Ct. 1992) ..... 25

***Ethyl Corp. v. Daniel Constr. Co.***,
725 S.W.2d 705 (Tex. 1987) ..... 24

***Garrity v. Lyle Stuart, Inc.***,
353 N.E.2d 793 (1976) ..... 14, 16, 17, 25, 27-29, 43

*Grissom v. Greener & Sumner Constr. Co.*,
676 S.W.2d 709 (Tex. App.--El Paso 1984,
writ ref'd n.r.e.) . . . . . 23, 26, 31, 36

*Gulf Oil Corp. v. Guidry*, 327 S.W.2d 406 (Tex. 1959) . 21, 33

*Gulf Oil Corp. v. Guidry*, 327 S.W.2d 406 (Tex. 1959) . . . . . *

*Honda Motor Co. v. Oberg*,
62 U.S.L.W. 4627 (June 24, 1994) 9, 13, 15, 18, 19, 22, 24-26

*Hotel & Rest. Employees & Bartenders Int'l Union
v. Michelson's Food Serv., Inc.*,
545 F.2d 1248 (9th Cir. 1976) . . . . . 20, 39

*House Grain Co. v. Obst*, 659 S.W.2d 903
(Tex App.--Corpus Christi 1983, writ ref'd n.r.e.) . . . . . 33

*Howard P. Foley Co. v. International Brotherhood
of Electrical Workers*, 789 F.2d 1421 (9th Cir. 1986) . . . . . 25

*International Bank, N.A. v. Morales*, 736 S.W.2d 622 (Tex.
1987) . . . . . 40, 41

*International Union of Operating Engineers v.
Mid-Valley, Inc.*,
347 F. Supp. 1104, 1109 (S.D. Tex. 1972) 22, 23, 25, 26, 36, 37

*Jim Walter Homes, Inc. v. Reed*,
711 S.W.2d 617 (Tex. 1986) . . . . . 40, 41

*John Wiley & Sons, Inc. v. Livingston*,
376 U.S. 543 (1964) . . . . . 38, 39

*Johnson v. Lynaugh*, 800 S.W.2d 936
(Tex. App.--Houston [14th Dist.] 1990, writ denied) . . . . . 9

*Manges v. Guerra*, 673 S.W.2d 180 (Tex. 1984) . . . . . 40, 43

*Pacific Mutual Life Ins. Co. v. Haslip*,
499 U.S. 1 (1991) ..... 7, 9-13, 15, 16, 18, 19, 22, 25, 26, 30

*Pool v. Ford Motor Co.*,
715 S.W.2d 629 (Tex. 1986) ..... 17

*Prudential Ins. Co. of Am. v. Jefferson Associates, Ltd.*,
839 S W.2d 866 (Tex. App.--Austin 1992, writ granted) .. 13

*Refinery Employees Union v. Continental Oil Co.*,
268 F.2d 447 (5th Cir. 1959) ..... 25

*Reyes v. State*,
741 S.W.2d 414 (Tex. Crim. App. 1987) ..... 23

*School City of East Chicago, Indiana v. East Chicago Federation of Teachers*,
422 N.E.2d 656 (Ind. Ct. App. 1981) ..... 17, 30

*Seale v. Roy M. Mitchell Contracting Co.*,
321 S.W.2d 149 (Tex. Civ. App.--Austin 1959, writ ref'd) . 31

*Shaw v. Kuhnel & Associates, Inc.*,
698 P.2d 880 (N.M. 1985) ..... 17, 29

*Smith v. Barnett*, 373 S.W.2d 762
(Tex. Civ. App.--Dallas 1963, no writ) ..... 37

*Southern Cotton Press & Mfg. Co. v. Bradley*,
52 Tex. 587 (1880)) ..... 7

*Southwestern Bell Telephone Co. v. Delaney*,
809 S.W.2d 493 (Tex. 1991) ..... 41

*Southwestern Bell Telephone Co. v. FDP Corp.*,
811 S.W. 2d 572 (Tex. 1991) ..... 41

*Texas Nat'l Bank v. Karnes*,
717 S.W.2d 901 (Tex. 1986) ..... 40, 41

*Transportation Ins. Co. v. Moriel*,
37 Tex. Sup. Ct. J. 883
(June 8, 1994) . . . . . 7, 14-19, 22, 24, 26, 27, 30

*TXO Production Corp. v. Alliance Resources Corp.*,
113 S. Ct. 2711 (1993) . . . . . 9, 12, 15, 16, 18, 19, 22, 25, 26

*United States Fidelity & Guaranty Co. v. DeFluiter*,
456 N.E.2d 429 (Ind. Ct. App. 1983) . . . . . 17, 29

*United Steelworkers v. Warrior & Gulf Navigation Co.*,
363 U.S. 574 (1960) . . . . . 31

*USX Corp v. West*, 781 S.W.2d 453
(Tex. App.-- Houston
[1st Dist.] 1989, no writ) ..... 21, 23, 26, 33, 36, 38, 39

*Valero Energy Corp. v. Wagner & Brown*, 777 S.W.2d 564
(Tex. App.--El Paso 1989, writ denied) ..... 31

*Westmoreland Coal Co. v. United Mine Workers*,
550 F. Supp. 1044 (W.D. Va. 1982) ..... 25

*Williams v. Khalaf*, 802 S.W.2d 651 (Tex. 1990) ..... 8, 9

**STATUTES AND RULES:**

TEX. CIV. PRAC. & REM. CODE § 41.003 (Vernon Supp. 1993) 42

TEX. CONST. art I, § 19 ..... 13

TEX. R. APP. P. 50(d) ..... 33

TEX. REV. CIV. STAT. ANN. art 224 (Vernon Supp. 1993) .. 30

TEX. REV. CIV. STAT. ANN. art. 238(A)(2) ..... 21, 32, 38

TEX. REV. CIV. STAT. ANN. arts 237 & 238 (Vernon 1973) 31, 37, 38

## STATEMENT OF THE CASE:

This appeal arises out the arbitration of a contract dispute among lawyers over the allocation of contingent fees from various cases. Although Donna C. Kline ("Kline") did not seek punitive damages, and there was no notice that punitive damages might be in issue in the Arbitration Proceeding, and Texas law does not allow the award of punitive damages under the facts of this dispute, the Arbitrators awarded punitive damages. The Trial Court then correctly entered Final Judgment in the amount of the actual damages awarded by the Arbitrators but modified and partially vacated the Award to set aside the punitive damages the Arbitrators had improperly attempted to award. Kline appealed. The Fourteenth Court of Appeals then modified the Trial Court's Final Judgment to award punitive damages against O'Quinn. As detailed in this Application for Writ of Error, there are numerous reasons why the Court of Appeals' decision is erroneous.

In the mid-80's, O'Quinn entered into an agreement with Don Maierson ("Maierson"), an attorney, with respect to certain "toxic tort" cases, often referred to as the ***Liberty Waste*** cases. Under this agreement, O'Quinn was to receive 45% of any fees recovered in the ***Liberty Waste*** cases, with Maierson to use the other 55% to pay himself and the other attorneys working on the case. [SOF 582-584; P. Exhs. 3 & 4] On March 1, 1988, Kline and O'Quinn and Thomas J. Pearson ("Pearson") entered into an agreement by which O'Quinn would fund and assist in certain cases. [Tr. 11-20] Later, Kline, O'Quinn, and Pearson entered into a second agreement dated January 20, 1989 [P. Exh. 7] detailing their understanding of how the fees were to be allocated (the "Agreement"). [Tr. 21-38]

Maierson, O'Quinn, Kline, and Pearson were ultimately successful in their representation of their clients in these cases. As a result of various settlements in the cases covered by the above agreements, sums were received for the clients and attorney's fees were recovered.

In early 1991, Kline filed suit against O'Quinn, Pearson, and Mbank (now Bank One, Texas, N.A.), claiming that they owed her additional attorney's fees from the settlements of certain lawsuits. [Tr. 2] As detailed in Kline's *Original Petition*, she sued O'Quinn and Pearson. Bank One was named in Kline's lawsuit, but no claim was made against Bank One. [Tr. 8] Kline alleged that O'Quinn and Pearson were in breach of their contractual obligations regarding the allocation of attorney's fees. Kline sought to recover the economic losses she claimed she sustained as a result of the breach of the Agreement by O'Quinn and Pearson. Although her lawsuit was to recover monies that she claimed she was owed under the Agreement, Kline also alleged that O'Quinn and Pearson breached an alleged tort duty of good faith and fair dealing and had assumed the duties of fiduciaries and had breached a fiduciary duty. O'Quinn answered and denied all wrongdoing. [Tr. 48]

After filing suit, on March 8, 1991, Kline then filed a demand for arbitration with the American Arbitration Association. [P. Exh. 76] Kline's demand for arbitration described the dispute as a "disagreement among attorneys over contingent fee recoveries." [P. Exh. 76] Kline also submitted her Original Petition to the AAA, together with an explanatory letter, which noted that the Original Petition "states Kline's position on the matters and controversy more clearly than the papers previously submitted" to the AAA. [Supp. Tr. 30-31] Neither Kline's demand for arbitration nor her Original Petition made any request for an award of punitive damages. [Tr. 2-10, Supp. Tr. 27-31] In her prayer, Kline requested only actual damages, attorney's fees, pre-judgment and post-judgment interest, and a declaration of the rights and duties of the parties with respect to each other. [Tr. 8-10] O'Quinn presented his claims for monies owed to him by Pearson and Kline. [Tr. 300-304]

Because the agreements among Kline, O'Quinn, and Pearson provided for arbitration, these three parties proceeded to arbitration before the AAA in Arbitration No.

70 194 0030 91 W. The arbitration hearing was held in May 1992. There was no transcript or other record maintained on the Arbitration Proceeding. On June 23, 1992, the Arbitrators issued their "Award of Arbitrators." [Tr. 81] The Arbitrators awarded Kline compensatory damages against O'Quinn, plus pre-Award and post-Award interest. Even though not pled for by Kline, the Arbitrators stated that O'Quinn was to pay Kline $50,000 in exemplary damages. The Award stated that each party shall bear its own attorneys fees and share equally in the fees and expenses of arbitration. The Arbitrators held that "all relief not specifically granted in the Award is hereby denied" [Tr. 81] and that the "Award is in full settlement of all claims and counterclaims submitted to this Arbitration" [Tr. 82].

Because the Arbitrators' Award improperly purported to assess punitive damages against him, O'Quinn timely sought review of the Award by the Arbitrators pursuant to Articles 232, 237 and 238 of the Texas General Arbitration Act. [Tr. 83] The Arbitrators summarily denied O'Quinn's Motion. [Tr. 96] O'Quinn then filed with the Trial Court his Motion to Vacate, or, Alternatively, Modify and Correct the Award. [Tr. 58-72] About the same time, Kline filed a motion, styled an Application for Decree, seeking to confirm the Award. [Tr. 78-80]. O'Quinn then filed an Opposition to Kline's Application for Decree [Tr. 99-108].

On October 2, 1992, the Trial Court held a hearing regarding the issues raised by O'Quinn's Motion to Vacate, or, Alternatively, to Modify and Correct the Award, and by Kline's Application for Decree. [Tr. 274-275] At this initial hearing, the Trial Court ruled that the arbitrators exceeded their authority by ordering O'Quinn to pay punitive damages and by ordering payment of the Award within thirty (30) days after it was signed (the Arbitrators did not give the parties time to file Motions for modification or have the courts consider the propriety of the Arbitrators' Award). [Tr. 274-275] At this second hearing, the Trial Court again ruled that the Arbitrators exceeded the scope of their authority by awarding punitive damages and by requiring payment of the award within thirty

(30) days. The Trial Court instructed the parties to brief the issue of what, if any, issues remained for trial with respect to Kline's claims against O'Quinn. On October 22, 1992, a letter was filed on behalf of Kline. [Tr. 126-130] This letter asserted once again that the Award should be confirmed. Kline also took the position, however, that if the Trial Court refused to completely confirm the Award, then the Trial Court should allow Kline to proceed to trial against O'Quinn on the issue of punitive damages. [Tr. 126-130]

On October 29, 1992, O'Quinn's attorneys filed a letter stating O'Quinn's position on the issues raised by Kline. [Supp. Tr. 13-24] O'Quinn pointed out that the doctrine of *res judicata* barred the re-litigation of the same factual transaction which was the subject of the arbitration proceeding and the resulting Award. Accordingly, O'Quinn's letter pointed out that there were no remaining issues for trial.

On October 30, 1992, O'Quinn filed his Motion for Judgment. [Tr. 274-276] On November 6, 1992, the Trial Court held a hearing on O'Quinn's Motion. At this third hearing, the Trial Court reconfirmed her prior rulings but declined to enter a Judgment incorporating her prior rulings. The Trial Court stated that there should be only one Judgment signed in this case and that such Judgment would be signed after all of the issues were resolved.

On December 18, 1992, the Trial Court held a pretrial hearing. At this pretrial hearing, the parties again addressed the issue of what, if any, issues remained for trial as between Kline and O'Quinn. [SOF PT 4-21][1] The Trial Court again ruled, as in its earlier hearings, that the portion of the Award purporting to grant punitive damages was incorrect and the Award would be modified. [SOF PT 21] The Trial Court also

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[1] The abbreviation PT stands for the PreTrial portion of the Statement of Facts. The record contains two volumes beginning with page 1, *i.e.*, the PreTrial volume and the first volume of the trial.

refused to allow Kline to recover her attorney's fees incurred in connection with confirming and enforcing the Award. [SOF PT 34] Kline then argued in the alternative that she should be entitled to a trial on the issue of punitive damages alone. [SOF PT 19-20] The Trial Court rejected this idea. [SOF PT 21]

Although the Trial Court's rulings made it clear that there were no issues remaining for trial as against O'Quinn, the Trial Court did not enter any written order. Instead, the Trial Court carried O'Quinn with the case, which proceeded to trial against Defendant Bank One on December 21, 1992. At the close of Kline's case in chief on September 28, 1992, Bank One moved for a directed verdict. [SOF 654] After listening to the parties' arguments, the Trial Court granted Bank One's motion. [SOF 670-71] The Trial Court then entered its *Final Judgment* on January 4, 1993. [Tr. 379-82] O'Quinn paid the Final Judgment as it applies to him. Kline appealed from the *Final Judgment*.

In his briefs before the Court of Appeals, O'Quinn urged the Fourteenth Court to affirm the Trial Court's Judgment on a number of grounds. Among other things, O'Quinn argued that punitive damages simply may not be awarded by arbitrators operating under Texas law because such awards (1) violate the public policy of the State of Texas and (2) violate the constitutional safeguards provided by the U.S. and Texas constitutions. Nonetheless, the Court of Appeals incorrectly sustained Kline's point of error No. 1, and held that the Trial Court incorrectly modified the arbitrator's award. O'Quinn urges this Court to reverse the decision of the Court of Appeals and affirm the Trial Court's Judgment.

## STATEMENT OF JURISDICTION:

The Texas Supreme Court has jurisdiction pursuant to Section 22.001(a)(1), (a)(3) & (a)(6) of the Texas Government Code.

## POINTS OF ERROR:

1. The Court of Appeals erred in reversing the portion of Trial Court's Judgment that modified the arbitration award to exclude punitive damages from the award. (Op. at 6-12.)

2. The Court of Appeals erred in holding that certain aspects of O'Quinn's Constitutional arguments were waived. (Op. at 11.)

3. The Court of Appeals erred in holding that the arbitration award of punitive damages may be affirmed without violating the United States or Texas Constitutions. (Op. at 11.)

4. The Court of Appeals erred in holding that the arbitration award of punitive damages may be affirmed without violating the United States or Texas Constitutions because arbitration proceedings in general lack the necessary safeguards required by the United States and Texas Constitutions for arbitrators to award punitive damages, even if the parties attempt to specifically bestow that right upon the arbitrators. (Op. at 11.)

5. The Court of Appeals erred in holding that the arbitration award of punitive damages may be affirmed without violating the United States or Texas Constitutions because arbitration proceedings in general lack the necessary safeguards required by the United States and Texas Constitutions for arbitrators to award punitive damages and thus arbitrators may not award punitive damages unless the parties have clearly and expressly waived their Constitutional rights by authorizing the arbitrators to award punitive damages. (Op. at 11.)

6. The Court of Appeals erred in holding that the arbitration award of punitive damages may be affirmed without violating the United States or Texas Constitutions because these arbitration proceedings as conducted denied O'Quinn's Due Process of law. (Op. at 11.)

7. The Court of Appeals erred in failing to adopt and apply as the public policy of Texas a rule that prohibits arbitrators from awarding punitive damages even when the parties attempt to grant the arbitrators the authority to award such relief. (Op. at 11-12.)

8. The Court of Appeals erred in failing to adopt and apply as the public policy of Texas a rule that prohibits arbitrators from awarding punitive damages unless the parties have specifically and expressly agreed to give the arbitrators the authority to award such relief. (Op. at 11-12.)

9. The Court of Appeals erred in reversing the portion of the Trial Court's Judgment that denied the award punitive damages because there is no legal basis for an award of punitive damages in this case. (Op. at 6-12 & 14-18.)

10. The Court of Appeals erred in concluding that the parties contemplated the arbitration of tort claims and especially claims for punitive damages. (Op. at 7-10.)

11. The Court of Appeals erred in concluding that the award of punitive damages was within the scope of the arbitrators' authority. (Op. at 6-10.)

12. The Court of Appeals erred in concluding that the arbitrators could have found that Kline's pleadings were sufficient to state a claim for punitive damages. (Op. at 8-10.)

13. The Court of Appeals erred in presuming that the evidence before the arbitrators supported an award of punitive damages. (Op. at 10.)

14. The Court of Appeals erred in holding that, as the losing party in arbitration, Mr. O'Quinn was required to bring forward to the Trial Court a complete record and all bases for vacating or modifying the Arbitration Award. (Supp. Op. at 2.)

## BRIEF OF THE ARGUMENT:

### I. This case involves important issues regarding punitive damages:

As this Court recently observed, punitive damages are "exceptional" in nature. ***Transportation Ins. Co. v. Moriel***, 37 Tex. Sup. Ct. J. 888, 886-87 (June 8, 1994). Indeed, Texas courts have long recognized the "close connection" between punitive damages and the criminal law:

> Such indifference is morally criminal, and if it leads to actual injury may well be regarded as criminal in law. A mere act of omission or non-feasance, to be punishable by exemplary damages, should reach the borderline of a quasi-criminal act of commission or malfeasance.

*Id.* at 886 (quoting ***Southern Cotton Press & Mfg. Co. v. Bradley***, 52 Tex. 587, 600-01 (1880)).

The United States Supreme Court also recently emphasized the special nature of punitive damages:

> Punitive damages pose an acute danger of arbitrary deprivation of property. Jury instructions typically leave the jury with wide discretion in choosing amounts, and the presentation of the evidence of defendant's net worth creates the potential that juries will use their verdicts to express biases against big businesses, particularly those without strong local presences. Judicial review of the amount awarded was one of the few procedural safeguards which the common law provided against that danger.

***Honda Motor Co. v. Oberg***, 62 U.S.L.W. 4627, 4631 (June 24, 1994); *see also* ***Pacific Mut. Life Ins. Co. v. Haslip***, 499 U.S. 1,

18 (1991) (expressing concern that unlimited jury discretion could allow punitive damages to "run wild").

This case presents important issues involving the special nature of punitive damages in the context of arbitration. The arbitrators' award of punitive damages in this case violated O'Quinn's Due Process rights. The award of punitive damages against O'Quinn violated the U.S. and Texas constitutions, as well as the public policy of Texas, because the arbitration process failed to provide the safeguards needed to protect against excessive and inappropriate awards of punitive damages.

## II. Arbitrators generally should not be allowed to award punitive damages: (Germane to Point of Error Nos. 1, 2, 3, 4, 5 & 6)

There are two fundamental reasons why arbitrators should not be allowed to award punitive damages in arbitration proceedings under Texas law. First, arbitration proceedings lack the substantive and procedural safeguards required by the Due Process Clause of the United States Constitution and the Due Course of Law Clause of the Texas Constitution. Second, allowing Arbitrators to award punitive damages is contrary to the public policies of this State. For the reasons discussed below, this Court should therefore reverse the Fourteenth Court's decision and affirm the Trial Court's Judgment.

### A. O'Quinn did not waive his Constitutional rights or the Constitutional arguments against allowing arbitrators to award punitive damages: (Germane to Point of Error No. 2)

The Fourteenth Court of Appeals divided O'Quinn's Constitutional arguments into two different groupings. The Court of Appeals acknowledged that O'Quinn raised below the issue of whether lack of notice as to punitive damages violated his Constitutional right to Due Process. The Court of Appeals in effect held that O'Quinn "waived" his Constitutional rights

of Due Process by signing a contract containing an arbitration provision -- although the arbitration provision said nothing of any such waiver and did not bestow on the Arbitrators the right to award punitive damages. Op. at 11. The Fourteenth Court of Appeals then declined to address O'Quinn's remaining Constitutional arguments on the basis that these arguments were not raised before the Trial Court. The Court of Appeals was incorrect on both counts.

We turn first[2] to the Court of Appeals' position that some aspects of O'Quinn's Constitutional arguments were waived because they were not specifically raised before the Trial Court. This is incorrect. O'Quinn was the prevailing party in the Trial Court. Kline, not O'Quinn, was the party who appealed from the Trial Court's *Final Judgment*. In the Court of Appeals, O'Quinn was the appellee. As the prevailing party in the Trial Court and the appellee in the Court of Appeals, O'Quinn was not required to argue every alternative theory on which the Trial Court could have based its decision. ***Williams v. Khalaf***, 802 S.W.2d 651, 658 (Tex. 1990); ***Boyce Iron Works, Inc. v. Southwestern Bell Tel. Co.***, 747 S.W.2d 785, 787 (1988). This Court's decisions make it clear that an appellee has not waived an alternative basis for supporting the trial court's decision simply because appellee did not make the alternative argument in the trial court.

Specifically, at the first hearing involving the arbitration award, the Trial Court ruled from the bench in favor of O'Quinn. As detailed in O'Quinn's Briefs filed with the Court of Appeals, the Trial Court reaffirmed this ruling on several occasions, including at the pretrial conference. Given the Trial Court's rulings, there was no reason for O'Quinn to assert

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[2] The Fourteenth Court conclusion that signing an agreement to arbitrate contractual disputes automatically waives Constitutional Due Process rights is addressed below, at pages 22-27. As detailed below, the better view is that arbitrators may not award punitive damages unless the contracting parties expressly agree that the arbitrators may do so.

additional and alternative arguments to support the Trial Court's ruling. Doing so would have wasted the Trial Court's time, as the judge had already ruled. As in ***Williams*** and in ***Boyce Iron Works***, O'Quinn remained free to raise these alternative grounds for the Trial Court's ruling on appeal. O'Quinn did just that. Because these additional grounds for affirmance involve fundamental Due Process rights under the United States and Texas constitutions, it is important for this Court to resolve these issues.

As authority for its conclusion that O'Quinn waived his Constitutional arguments, the Fourteenth Court cited ***Johnson v. Lynaugh***, 800 S.W.2d 936, 939 (Tex. App.--Houston [14th Dist.] 1990, writ denied). However, ***Johnson*** involved waiver by an appellant, not an appellee. As noted, however, O'Quinn was the appellee. O'Quinn respectfully submits that ***Johnson*** simply does not apply here. Instead, ***Williams*** and ***Boyce Iron Works*** apply. Consequently, O'Quinn's Constitutional arguments regarding the ability of arbitrators to award punitive damages is properly before this Court.

**B. Because arbitration proceedings fail to meet the Constitutional requirements applicable to punitive damages, arbitrators should not be permitted to award punitive damages: (Germane to Points of Error No. 3, 4, 5 & 6)**

The concept of punitive damages has its roots in the English common law and was recognized in early American jurisprudence. Over the past two centuries, courts in our country and in the State of Texas have summarily found that punitive damage awards are Constitutional. Recently, however, the United States Supreme Court and this Court have re-examined the Due Process requirements applicable to punitive damages. The decisions by the Supreme Court and this Court are extremely important because they explain the Due Process requirements which apply to punitive damages. As detailed

below, the Due Process safeguards are conspicuous in their absence from arbitration proceedings.

**1. The U.S. Supreme Court's decisions in *Oberg*, *Haslip* and *TXO* demonstrate the Constitutional requirements applicable to awards of punitive damages:**

The Supreme Court recently emphasized that Due Process requires the judicial review of jury awards of punitive damages. ***Honda Motor Co. v. Oberg***, 62 U.S.L.W. 4627 (June 24, 1994). In ***Oberg***, the Court struck down an Oregon law which prohibited judicial review of the amount of punitive damages awarded by a jury. ***Id.*** at 4631. In reaching this conclusion, the Supreme Court emphasized the special nature of punitive damages and the "acute danger of arbitration deprivation of property" from punitive damages. ***Id.*** In addition, the Court emphasized that judicial review of punitive damages was "one of the few procedural safeguards which the common law provided against that danger." ***Id.*** The Supreme Court earlier had emphasized the importance of such procedural safeguards in the Court's cases leading to the ***Oberg*** decision.

Earlier, in ***Pacific Mutual Life Ins. Co. v. Haslip***, 499 U.S. 1 (1991), the Supreme Court held that the traditional common law method for assessing punitive damages is not so inherently unfair as to deny Due Process and to be *per se* unconstitutional. The Court went on to hold, however, that unlimited jury discretion -- or unlimited judicial discretion for that matter -- in fixing of punitive damages may invite extreme results that jar one's constitutional sensibilities. ***Id.*** at 18. The Supreme Court stated that the jury's discretion as to punitive damages is constitutional only when a trial court gives the jury reasonable and adequate guidance in making such awards. The Supreme Court noted that under Alabama law, as under the law of most states, punitive damages are imposed for purposes of retribution and deterrence, not to compensate the plaintiff for any injury. The Court observed that the instructions in ***Haslip***

informed the jury that its discretion should be guided by this purpose. ***Id.*** at 19.

In addition, the Supreme Court in ***Haslip*** indicated that punitive damages are constitutional only when the instructions given to the jury describe the standards to be used by the jury in determining whether to impose such awards. Although juries are given significant discretion in assessing punitive damages, that discretion is not unlimited. In ***Haslip***, the Court found that the jury's discretion was confined by appropriate instructions about deterrence and retribution and the state policy concerns sought to be advanced. ***Id.*** at 19-20. The Court found that the jury was instructed that if punitive damages were to be awarded, the jury "must take into consideration the character and degree of the wrong as shown by the evidence and necessity of preventing similar wrong." ***Id.*** at 19.

The Supreme Court in ***Haslip*** held that the discretion vested in the jury under the traditional common law rules may be justified as constitutional by the existence of post-trial procedures for scrutinizing punitive damage awards. ***Id.*** at 20-21. In ***Haslip***, the Court indicated that the procedures established by the Alabama courts ensured meaningful and adequate review by the trial court of punitive damages. The Court noted that the Supreme Court of Alabama had established post-trial procedures for scrutinizing awards of punitive damages. Under this procedure, Alabama trial courts must state in the record the reasons for interfering with a jury verdict, or refusing to interfere with a jury verdict, on grounds of excessiveness of the damages. Among the factors deemed appropriate for an Alabama trial court's consideration are: (1) the culpability of the defendant's conduct, (2) the desirability of discouraging others from similar conduct, (3) the impact upon the parties, and (4) other factors, such as the impact on innocent third parties. ***Id.*** at 21-22. The United States Supreme Court held that this test ensures meaningful and adequate review by the Trial Court whenever a jury has awarded punitive damages. ***Id.*** at 22.

The Court went on to state that the appellate procedures established by the Alabama Supreme Court provide still another check on the jury's or trial court's discretion in awarding punitive damages. ***Id.*** In Alabama, the reviewing court first undertakes a comparative analysis and then it applies detailed substantive standards the Alabama Supreme Court has developed for evaluating punitive awards. In so doing, it reviews the award to ensure that it does not exceed an amount that will accomplish society's goal of punishing and deterrence. ***Id.*** The Court noted that this appellate review makes certain that the punitive damages are reasonable in amount and rational in light of their purpose to punish and deter. The United States Supreme Court noted that the Supreme Court of Alabama has elaborated and refined specific criteria for determining whether a punitive award is reasonably related to the goals of deterrence and retribution. ***Id.*** at 21-22.

The Court concluded that the application of these standards imposes a sufficiently definite and meaningful constraint on the discretion of Alabama fact finders in awarding punitive damages. The Supreme Court held that these standards have real effect when applied by the Alabama Supreme Court to jury awards. The Supreme Court noted that these standards have resulted in the reduction of punitive awards in Alabama and that they provide for a rational relationship in determining whether a particular award is greater than necessary to punish and deter. ***Id.*** at 22.

In ***TXO Production Corp. v. Alliance Resources Corp.***, 113 S. Ct. 2711 (1993), the United States Supreme Court again considered the limits imposed by Due Process on awards of punitive damages. The Court concluded that because West Virginia law requires that punitive damages bear a reasonable relationship to compensatory damages, the magnitude of the potential harm that defendant's conduct could have caused, as well as to the possible harm to the other victims that might have resulted if similar future behavior were not deterred, there was sufficient concern by the West Virginia trial courts with the

reasonableness of the award such so as to meet the substantive requirements of the Due Process Clause. ***Id.*** at 2720-721.

Turning to the procedural component of the due process clause, the Court indicated that the inquiry could include whether the punitive damages award is a result of a fundamentally unfair procedure because the jury was not adequately instructed, whether the award was adequately reviewed by the trial or appellate courts, and whether the defendant had no advance notice that the jury might be allowed to return such a large award or to rely on potential harm as a basis for its calculation. The Court declined to address the first argument as it was not argued or passed on below. The Court concluded that in fact the jury's award was adequately reviewed by the trial court and the appellate court and that defendant had notice under prior law that punitive damages could be awarded under the circumstances of the case. Thus, the United States Supreme Court found no procedural violation of Due Process as a result of the procedures used in West Virginia for the awarding of punitive damages. ***Id.*** at 2720-724.

Significantly, West Virginia law prevents arbitrators from awarding punitive damages. As observed by the West Virginia Supreme Court, "where the damages are genuinely intended to be punitive and bear no reasonable relation to the prevailing party's commercial loss, they are beyond the scope of the arbitrator's power." ***Anderson v. Nichols***, 359 S.E.2d 117, 121 n.1 (W.Va. 1987). In other words, the same court that in ***TXO*** affirmed a punitive damages award rendered by a jury refuses to allow arbitrators to award punitive damages.

As noted above, the Supreme Court most recently held that Due Process requires judicial review of punitive damages awards. ***Honda Motor Co. v. Oberg***, 62 U.S.L.W. 4627 (June 24, 1994). In ***Oberg***, the Supreme Court summarized its rationale as follows:

> Punitive damages an acute danger of arbitrary deprivation of property. Jury instructions typically

> leave the jury with wide discretion in choosing amounts, and the presentation of evidence of a defendant's net worth creates the potential that juries will use their verdicts to express biases against big businesses, particularly those without strong local presences. Judicial review of the amount awarded was one of the few procedural safeguards which the common law provided against that danger. Oregon has removed that safeguard without providing any substitute procedure and without any indication that the danger of arbitrary awards has in any way subsided over time. For these reasons, we hold that Oregon's denial of judicial review of the size of punitive damage awards violates the Due Process Clause of the Fourteenth Amendment.

*Id.* at 4631. As detailed below, ***Oberg*** requires the reversal of the Opinion below, as the arbitration award of punitive damages violated O'Quinn's Due Process rights.

**2. The Texas Supreme Court's decision in *Moriel* also demonstrates the importance of safeguards on awards of punitive damages:**

The Texas Constitution contains its own Due Process Clause. TEX. CONST. art I, § 19. In the last several years, the Texas courts have dealt with the constitutionality of awards of punitive damages. *See, e.g.*, ***Browning-Ferris Indus., Inc. v. Lieck***, 845 S.W.2d 926, 943-47 (Tex. App.--Corpus Christi 1993), *rev'd on other grounds*, 37 Tex. Sup. Ct. J. 851 (June 2, 1994); ***Prudential Ins. Co. of Am. v. Jefferson Associates, Ltd.***, 839 S.W.2d 866, 876-77 (Tex. App.--Austin 1992, writ granted). In ***Jefferson Associates***, for example, the Court of Appeals for Austin held that a jury's award of punitive damages did not violate the Due Process Clause of the United States Constitution or the Texas Constitution because many of the

judicial safeguards mentioned in ***Haslip*** also apply in the Texas state courts. The Austin Court of Appeals noted that the opportunity for review by a trial court is available by both the trial court and the appellate courts.

This Court recently addressed the imposition of punitive damages in ***Transportation Ins. Co. v. Moriel***, 37 Tex. Sup. Ct. J. 883 (June 8, 1994). In ***Moriel***, this Court recognized that *punitive damages* are quasi-criminal in nature. The Court noted the close connection between punitive damages and the criminal law. *See* ***Moriel***, 37 Tex. Sup. Ct. J. at 886. This same view formed an important basis for the New York Court of Appeals' decision in ***Garrity v. Lyle Stuart, Inc.***, 353 N.E.2d 793 (1976), which held that arbitrators may not award punitive damages. The Court also noted in ***Moriel*** that the U.S. constitution imposes certain limitations on awards of punitive damages. ***Id.*** at 895-98.

In ***Moriel***, this Court declined to declare unconstitutional or otherwise change the principle that its review of punitive damage awards extends only to determining whether the evidence supporting the award was *legally sufficient*. ***Id.*** at 899.[3] The Texas ***Moriel*** Court held that the evidence presented by Moriel was *legally sufficient* to sustain the judgment that the insurer acted without any reasonable basis in delaying the payment of the claim and thus was liable in tort for breach of the duty of good faith and fair dealing. The Court held, however, that under the clarified definition of *gross negligence*, the insurer cannot be held liable for *punitive damages* unless there is also *legally sufficient* evidence (a) that the defendant's conduct created an *extreme risk of harm*, and (b) that the defendant was consciously indifferent to this *extreme risk of*

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[3] As will become apparent from the following discussion, the evolution of the Due Process protection against excessive and inappropriate punitive damage awards by the U.S. Supreme Court may well require a change in the way Texas courts review punitive damage awards.

*harm* or was actually aware of this *extreme risk of harm*. ***Id.*** at 891.

The ***Moriel*** Court expressly stated that because the plaintiff did not present legally sufficient evidence of *gross negligence*, the Constitutional issues (*e.g.*, whether the size of the punitive damages award or whether the procedures followed by the trial court violated the defendant's Due Process rights) remained open questions. Nevertheless, in remanding the case for a new trial, this Court reviewed the Constitutional Due Process analyses in ***Pacific Mutual Life Ins. Co. v. Haslip***, 499 U.S. 1 (1991), and in ***TXO Prod. Corp. v. Alliance Resources Corp.***, 113 S.Ct. 2711 (1993). This Court also noted that the Supreme Court had granted writs in ***Oberg***. Although this Court did not explicitly rule on the Constitutional issues, the Court correctly chose to emphasize the need for common law safeguards in order to satisfy Due Process requirements.

In ***Moriel***, this Court first focused on the Texas state court procedures for awarding punitive damages at the trial court level. The Court noted that at the trial court level, the jury instructions used in the trial of the ***Moriel*** case, which appear to have been based upon the Texas pattern jury charge and ***Alamo National Bank v. Kraus***, 616 S.W.2d 908, 910 (Tex. 1981), were more comprehensive than those analyzed by the United States Supreme Court in ***Haslip*** and thus would presumably pass scrutiny under the United States Constitution. 37 Tex. Sup. Ct. J. at 896, n.22.

Constitutional standards also involve post-verdict procedures for scrutinizing the jury's award of punitive damages. This is clearly so at the Trial Court level. While the Supreme Court indicated in ***Haslip*** and ***TXO*** that such post-verdict procedures *should* also exist at the appellate level, the Supreme Court held in ***Oberg*** that such procedures *must* exist. In ***Moriel***, this Court noted that the Supreme Court in ***Haslip*** emphasized a post-verdict procedure where the trial courts are required to scrutinize punitive damage awards, reflecting on the record their reason for upholding or refusing to uphold the

award, ***Moriel***, 37 Tex. Sup. Ct. J. at 896, and also emphasized the fact that the appellate review in Alabama provides an additional check on the jury's or trial court's discretion. ***Id.*** at 896. This Court observed that, by contrast, in Texas a defendant *may* obtain trial court review of a punitive damage award by filing a motion for new trial, but there is no requirement for the trial courts to scrutinize each award and set forth reasons on the record for refusing to disturb a jury's verdict. ***Id.*** at 897. Indeed, Texas trial courts are not even required to rule on a motion for new trial; they may ignore the motion and passage of time will serve to overrule the new trial motion by operation of law. ***Id.*** at 897.

Moving further up the ladder of post-verdict review, the Texas courts of appeal may overturn the jury's verdict and order the case retried only if the verdict is so against the great weight and preponderance of the evidence as to be manifestly unjust. ***Id.*** at 897. Finally, this Court, unlike its counterparts in Alabama and West Virginia and most other States, is precluded from reviewing the evidence supporting a punitive damage award for factual sufficiency. ***Id.*** The ***Moriel*** Court concluded that under Texas procedures, the evidence supporting a punitive damage award is scrutinized less closely on appeal than in some other states. ***Id.*** Indeed, this Court stated that many aspects of the procedures employed up to now by Texas courts do not compare favorably to those examined in ***Haslip*** and ***TXO***. ***Id.*** at 897-98.

Recognizing, as has New York's highest court in ***Garrity***, the close connection between punitive damages and the criminal law, this Court stated that punitive damages are proper only in the most exceptional cases and that the jury discretion which is the hallmark of the common law punitive damage system **must** be complemented by procedural safe-guards that will ensure against (i) excessive or (ii) *otherwise inappropriate* awards. (emphasis added.) ***Id.*** at 897-98. This Court concluded that the Texas procedures for assessing and reviewing punitive damage awards, both at the trial and appellate levels, in some respects may not adequately ensure

that such awards are not grossly out of proportion of the severity of the offense and have some understandable relationship to compensatory damages. *Id.* at 898.

In an effort to address these shortcomings, this Court articulated procedural standards for the Trial Courts in this State to apply with respect to claims for *punitive damages*. Without reaching the constitutional questions, this Court announced, pursuant to its authority under the common law (the same foundation used by the New York Court of Appeals in *Garrity* and other courts to prohibit arbitrators from awarding punitive damages[4]), two changes in the procedures by which punitive damages may be awarded in the Texas state courts. The changes are:

a. The issue as to the amount of punitive damages must be bifurcated from the remaining issues in the trial of the Cause. 37 Tex. Sup. Ct. J. at 898-99. This Court concluded that the current procedures are not adequate and thus adopted the requirement of bifurcated trials in punitive damages cases.

b. The courts of appeal are already obligated, when reversing a jury's award on insufficiency grounds, to detail the evidence in their opinions and explain why the jury's finding is factually insufficient or so against the great weight and preponderance of the evidence as to be manifestly unjust. ***Pool v. Ford Motor Co.***, 715 S.W.2d 629, 635 (Tex. 1986). In ***Moriel***, this Court extended this obligation. Now, the reviewing courts of appeal are also obligated to detail the evidence in their opinions when they are affirming an award of

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[4] *See* ***Shaw v. Kuhnel & Associates, Inc.***, 698 P.2d 880 (N.M. 1985); ***United States Fidelity & Guaranty Co. v. DeFluiter***, 456 N.E.2d 429 (Ind. Ct. App. 1983); ***School City of East Chicago, Indiana v. East Chicago Federation of Teachers***, 422 N.E.2d 656 (Ind. Ct. App. 1981).

> punitive damages over a challenge that it is based on insufficient evidence or against the great weight and preponderance of the evidence. This Court held that this procedure will ensure careful appellate review of the punitive award and allow the Texas Supreme Court to determine whether the court of appeals correctly applied the ***Kraus*** factors. 37 Tex. Sup. Ct. J. at 899.

Given ***Oberg*** and the Due Process requirement of judicial review, additional changes to Texas procedures may be needed to ensure against excessive or otherwise inappropriate punitive damage awards.

**3. The safeguards emphasized by the United States Supreme Court and the Texas Supreme Court in *Oberg*, *TXO*, *Haslip*, and *Moriel* are completely absent from arbitration proceedings:**

There is nothing in an arbitration proceeding to ensure against excessive or otherwise inappropriate punitive damage awards. None of the protection -- not a single one -- discussed by the Supreme Court in ***Oberg***, ***Haslip*** and ***TXO***, or discussed and required by this Court in ***Moriel***, is present in an arbitration proceeding. There is no voir dire of the potential arbitrators to determine their biases against the defendant or their feelings as to the award of punitive damages. Discovery is abbreviated, which can result in the defendant being denied the opportunity to develop the facts necessary to refute the plaintiff's allegations. There are few evidentiary rules applicable to an arbitration proceeding; virtually everything is admissible into evidence. Hence, there is no procedure for controlling and limiting the evidence submitted to the Arbitrators and the statements made by the parties and their advocates to the Arbitrators. Virtually anything can be done or said during an arbitration hearing -- and apparently was in this case.

There is no procedure whereby the arbitrators are provided, either by the Trial Court or the American Arbitration Association or some other supervising organization, instructions that articulate the purposes of punitive damages. Unlike juries, arbitrators are not instructed that punitive damages are to punish and to deter the defendant, nor are arbitrators instructed as to when and under what circumstances the law allows the award of punitive damages.

Because punitive damages are so subjective, the United States and Texas constitutions require judicial supervision by the trial or appellate courts. However, one of the underlying

theories of arbitration is that there should be minimal court review and supervision. Indeed, the Court of Appeals in this case deferred to the arbitrators as to "procedural matters such as the sufficiency of Kline's pleadings" and then presumed "adequate evidence to support the award." Op. at 10. Because there is rarely a record of the arbitration proceedings, arbitrators sometimes choose not to state their reasoning or the bases for their decision, making it is almost impossible for reviewing courts to supervise the proceedings or the arbitrators' award. While this seems acceptable for compensatory damages, allowing arbitrators to award *punitive* damages will lead to unpredictable, uncontrollable, non-reviewable awards of punitive damages.

There is no procedure applicable to arbitration awards for the trial court or the appellate courts to review the testimony and documents considered by the arbitrators or the basis on which the arbitrators made their award of punitive damages. Similarly, there is no procedure for the trial court or the appellate court to determine whether the award of punitive damages by the arbitrators is excessive taking into account the factors articulated by this Court: (i) whether the exemplary damages are reasonably proportional to actual damages, (ii) the nature of the wrong, (iii) the character of the conduct involved, (iv) the culpability of the wrongdoer, (v) the situation and sensibilities of the parties, and (vi) the extent to which the wrongful conduct offends a public sense of justice and propriety. *See, e.g., **Alamo National Bank v. Kraus***, 616 S.W.2d 908, 910 (Tex. 1981).

**4. The arbitration proceedings at issue in this case were even worse than usual in terms of the absence of Due Process safeguards against punitive damages:**

Due Process of law applies in arbitration proceedings just as in other legal proceedings. This requires fair notice of the claims made by the other party. In this case, Kline's pleadings

and submission to the arbitrators gave O'Quinn absolutely no notice of any claim for punitive damages. By letter of May 28, 1991 from Kline's counsel to the American Arbitration Association, Kline's counsel transmitted the Original Petition to the AAA as the definition of Kline's claim. In her Original Petition, Kline alleged breach of contract, breach of an alleged tort duty of good faith, and breach of an alleged fiduciary duty. Kline pled and prayed only for actual damages, *i.e.*, economic losses. Kline did not plead or pray for exemplary damages. Indeed, there is no mention -- not one single word -- in the Original Petition about exemplary damages. Moreover, Kline did not plead the existence of a separate and distinct tort that caused separate actual damages in tort, which is required by Texas law for the recovery of punitive damages.

Kline requested punitive damages only at the conclusion of the arbitration, *i.e.*, only after the evidence had been presented. In such a situation, the arbitrators' award of punitive damages cannot stand because it exceeded their authority and constitutes an award on a matter not submitted. *See* TEX. REV. CIV. STAT. ANN. art. 237(A)(3) (award to be vacated when arbitrators exceed their authority) & art. 238(A)(2) (award to be modified when arbitrators award on a matter not submitted).

In similar cases involving a belated claim for punitive damages other courts have vacated the arbitrator's award of punitive damages. For example, in ***Hotel & Rest. Employees & Bartenders Int'l Union v. Michelson's Food Serv., Inc.***, 545 F.2d 1248, 1254 (9th Cir. 1976), the court held that the failure to request punitive damages from the onset prevented the assertion of such a claim in arbitration. In ***Michelson's***, the aggrieved employee waited until the day the arbitration hearing was to begin to assert a claim for punitive damages. The Ninth Circuit refused to allow the arbitrator to award such damages, observing:

> What we do say is that the remedies here claimed are not usually appropriate in breach of contract cases

> [citation omitted] and that such extraordinary remedies are not available at the arbitration stage unless they have been put in issue from the beginning. We express no opinion as to what the arbitrator's powers would be in such a case; it is not before us.

***Michelson's***, 545 F.2d at 1254. *See also* ***Totem Marine Tug & Barge, Inc. v. North American Towing, Inc.***, 607 F.2d 649, 651-652 (5th Cir. 1979) (vacating arbitration award of charter hire damages where such damages were not requested in the parties' submission of claims to the arbitrators).

The Texas General Arbitration Act requires the courts to modify or correct an award if the arbitrators issue an award on "a matter not submitted to them..." TEX. REV. CIV. STAT. ANN. art. 238(A)(2). This Court (and most others) consider the parties' letters and pleadings which are provided to the arbitrators in determining the scope of the matters submitted to arbitration. *See, e.g.,* ***Gulf Oil Corp. v. Guidry***, 327 S.W.2d 406, 407-11 (Tex. 1959) (considering various papers and correspondence among the arbitrators); ***USX Corp. v. West***, 781 S.W.2d 453, 455 (Tex. App.--Houston [14th Dist.] 1989, no writ) (considering papers submitted to the American Arbitration Association); *see also* ***Totem Marine***, 607 F.2d at 651-52 (considering letter to arbitrator in determining what issues were submitted to arbitration). Hence, Kline's statement of her claims via her submissions to the arbitrators is extremely important -- those papers determine what was submitted to the arbitrators. The Trial Court, referring in part to Kline's own statement of the issues submitted to the Arbitrators, correctly modified the Award to vacate the portion thereof where the Arbitrators exceeded their authority. However, the Court of Appeals incorrectly ignored Kline's own submissions to the arbitrators, suggesting that Kline's own submission to the arbitrators constitutes "extrinsic evidence" which need not be considered. Op. at 10.

The Fourteenth Court's refusal to examine the submissions to the Arbitrators shows a complete absence of judicial review,

as is required under ***Oberg***. The injustice of the Fourteenth Court's decision is underscored when one considers its conclusion that O'Quinn had no fiduciary duty to Kline. Op. at 17-18. In other words, the Fourteenth Court essentially rejected any possible basis for an award of punitive damages. Nonetheless, its deference to the arbitrators and its refusal to review the award led it to reinstate an award of punitive damages which, by its own analysis, had absolutely no legal basis.

**5. Contracting parties do not waive their Due Process rights with respect to punitive damages simply by agreeing to arbitrate -- unless they expressly agree to allow arbitrators to award punitive damages:**

Arbitration is entirely consensual. Unless there is a *contract* containing an arbitration provision, there is no arbitration. *Contracting* parties elect to submit their future disputes to arbitration for the purpose of a private, speedy and fair resolution, without the delays and rigidities of a court trial. They expect their arbitrators to award the type of relief that the law allows for breach of *contract*. They do not expect the arbitrators to award punitive damages, particularly when the law does not allow the recovery of punitive damages for *breach of contract*. *E.g.*, ***Belko v. AVX Corp.***, 251 Cal. Rptr. 557, 560-61 (Cal. Ct. App. 1988); ***International Union of Operating Engineers v. Mid-Valley, Inc.***, 347 F. Supp. 1104, 1109 (S.D. Tex. 1972).

It is one thing for *contracting* parties to submit to arbitration the issue of *contractual* **compensatory** damages, which are largely based on objective criteria. But **punitive** damages are entirely different. Punitive damages are quasi-criminal and subjective in nature. As stated by the Supreme Court in ***Oberg*** and as this Court held in ***Moriel***, the jury discretion that is the hallmark of the common law punitive damage system **must** be complemented by procedural safe-

guards that will ensure against excessive or otherwise inappropriate awards. It is inconceivable, and simply cannot be the case, that when parties submit their *contractual* disputes to arbitration they face the risk of having punitive damages awarded against them without any substantive and procedural safeguards to ensure against excessive or inappropriate punitive damage awards.

Parties do not "waive" their fundamental substantive and procedural rights simply by agreeing that their future *contract* disputes will be resolved by arbitration. As one federal court in Texas explained:

> Contracting parties do not normally agree to assess exemplary damages for a breach of contract. Such damages being punitive in nature are rare in contract law. Contractual consent to so drastic a "remedy" for simple breach cannot be implied. ***Therefore, a arbitrator's assessment of punitive damages must be grounded in express language.*** In this case, neither the contract clause nor the simple question submitted suggest authority for exemplary damages.

***Mid-Valley***, 347 F. Supp. at 1109 (emphasis added). Under this approach, arbitrators may award punitive damages only if expressly allowed by the parties' agreement.

The view adopted in ***Mid-Valley*** is entirely consistent with the few Texas cases on point. In ***Grissom v. Greener & Sumner Constr. Co.***, 676 S.W.2d 709 (Tex. App.--El Paso 1984, writ ref'd n.r.e.), for example, the parties expressly agreed to submit contract and tort claims, and all pending claims for damages, including punitive damages, to arbitration. In ***USX Corp. v. West***, 781 S.W.2d 453 (Tex. App.--Houston [1st Dist.] 1989, no writ), the court refused to require the parties to arbitrate all claims, instead observing that the question of whether tort claims and claims for punitive damages should be submitted to arbitration was initially a procedural matter for the arbitrations. Unlike this case or ***Grissom***, however, ***USX*** did not deal with

the review of an arbitration award. Rather, ***USX*** dealt with procedural skirmishes in connection with the submission of the case to arbitration. ***Mid-Valley***, ***Grissom***, and ***USX*** together suggest that arbitrators may award punitive damages only where the parties have expressly granted such authority. O'Quinn never agreed to allow the arbitrators such unlimited discretion.

In addition to the above, there are additional reasons for requiring the parties' express consent to allow arbitrators to award punitive damages. For one thing, the exceptional and quasi-criminal nature of punitive damages must weigh heavily in determining whether there has been a waiver of Due Process rights. In connection with a waiver of Fourth Amendment rights (which protect against criminal penalties), the Texas courts require that the prosecution "show by clear and convincing evidence that the consent to search was freely and voluntarily given." The prosecution must show the consent was "positive and unequivocal." *E.g.*, ***Reyes*** . ***State***, 741 S.W.2d 414, 430 (Tex. Crim. App. 1987).

Given the close connection between criminal law and punitive damages, the waiver standard applicable to other constitutional safeguards against criminal penalties should control the determination of whether a contracting party has waived his or her constitutional safeguards against an excessive award of punitive damages by an arbitrator. As previously noted, this Court recently emphasized the close connection between punitive damages and the criminal law. ***Moriel***, 37 Tex. Sup. Ct. J. at 886-87. As indicated in ***Moriel*** and ***Oberg***, the special nature of punitive damages suggests that a waiver of the Due Process safeguards against excessive punitive damages cannot be lightly inferred. Compliance with the express consent rule, which requires that a party expressly agree that an arbitrator may assess punitive damages, should also satisfy Due Process requirements. Accordingly, O'Quinn respectfully requests that this Court adopt and apply the express consent rule in determining whether the arbitrators were authorized to award punitive damages.

Another significant reason for applying the express consent rule can be found in this Court's recent indemnity cases. In ***Ethyl Corp. v. Daniel Constr. Co.***, 725 S.W.2d 705 (Tex. 1987), this Court adopted the "express negligence doctrine," which requires that a party seeking indemnity from its own negligence "must express that intent in specific terms within the four corners of the contract." ***Id.*** at 707-708. This rule is intended to protect unsuspecting indemnitors from indemnity claims where the indemnitee was also negligent, in order to avoid results not reasonably expected by the indemnitor. More recently, this Court extended the conspicuousness requirement of ***Ethyl*** to cover "first party" exculpatory clauses amounting to a release of claims for future negligent conduct. ***Dresser Ind., Inc. v. Page Petroleum, Inc.***, 853 S.W.2d 505, 510-11 (Tex. 1993). Such requirements help to ensure that "a reasonable person against whom a clause is to operate" will have noticed it. ***Id.*** at 511.

As previously noted, contracting parties generally do not expect that arbitrators may award punitive damages. *E.g.*, ***International Union of Operating Engineers v. Mid-Valley, Inc.***, 347 F. Supp. 1104, 1109 (S.D. Tex. 1972). As with indemnity and exculpatory clauses, parties who agree to arbitration ought to receive fair notice of what may be arbitrated. Given the exceptional nature of punitive damages and their general unavailability in contract cases, an express consent rule is needed to avoid surprise and unexpected results. In other words, arbitrators should not be deemed to have the authority to award punitive damages unless the parties expressly agree that they may do so. Such a rule encourages the use of arbitration by avoiding unexpected results and surprise. It also protects against constitutional violations by arbitration awards not subject to any judicial review, as otherwise required by ***Oberg***.

Other state courts have considered the extent to which arbitrators may award punitive damages.[5] Some courts flatly refuse to allow arbitrators such unlimited power. *E.g.*, ***Garrity v. Lyle Stuart, Inc.***, 353 N.E.2d 793 (N.Y. 1976). Other courts refuse to allow arbitrators to award punitive damages unless the parties expressly agree that they may do so. In other words, these latter courts impose an "express consent" requirement before arbitrators may award punitive damages. *E.g.*, ***Edward Elec. Co. v. Automation, Inc.***, 593 N.E.2d 833, 842-43 (Ill. App. Ct.), *appeal denied*, 602 N.E.2d 450 (Ill. 1992) (vacating severable award of punitive damages); ***Complete Interiors, Inc. v. Behan***, 558 So.2d 48, 50-51 (Fla. Dist. Ct. App.), *review denied*, 570 So.2d 1303 (Fla. 1990); ***Belko v. AVX Corp.***, 251 Cal. Rptr. 557, 560-61 (Cal. Ct. App. 1988). In addition, numerous federal courts have considered this issue and have concluded that arbitrators cannot award punitive damages absent an express agreement to that effect. *E.g.*, ***Howard P. Foley Co. v. International Brotherhood of Electrical Workers***, 789 F.2d 1421, 1424 (9th Cir. 1986); ***Baltimore Regional Joint Bd. v. Webster Clothes, Inc.***, 596 F.2d 95, 98 (4th Cir. 1979); ***Westmoreland Coal Co. v. United Mine Workers***, 550 F. Supp. 1044, 1047-48 (W.D. Va. 1982); ***Mid-Valley***, *supra*, 347 F. Supp. at 1109-10.

It is significant to note that the cases adopting the express consent rule avoid the nettlesome constitutional issues now before this Court. As in ***Moriel***, this Court remains free to adopt and apply the same "express consent" rule. As noted above, this rule is consistent with prior Texas cases (i.e., ***Mid-Valley***, ***Grissom*** and ***USX***).

Applying the express consent rule in this case requires a reversal of the Opinion below and affirmation of the Trial Court's Judgment. As set forth in the Opinion below, the arbitration clause failed to expressly allow arbitration of

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[5] These decisions, however, generally were made prior to the decisions in ***Oberg***, ***TXO***, and ***Haslip***. Hence, the Due Process requirements may require even stricter judicial review.

punitive damages, let alone any express reference to tort claims. Op. at 7. Under the express consent rule, the award of punitive damages exceeded the arbitrators' authority and was correctly set aside by the Trial Court. *See* TEX. REV. CIV. STAT. ANN. art 237 & 238 (Vernon 1973) (requiring the court to vacate or modify an arbitration award where the arbitrators exceed their authority or have awarded on a matter not submitted); ***Mid-Valley***, *supra*; ***Grissom v. Greener & Sumner Constr. Co.***, 676 S.W.2d 709 (Tex. App.--El Paso 1984, writ ref'd n.r.e.) (affirming arbitration award of punitive damages where the parties expressly agreed to submit this issue to arbitration). A rule disallowing punitive damages in arbitration unless the parties have expressly agreed otherwise is consistent with the constitutional limitations of ***Oberg***, ***TXO***, ***Haslip***, and ***Moriel***, yet is also consistent with ***Grissom***, ***Mid-Valley***, and the express consent cases. It is unrealistic to assume that when parties agree to arbitrate future disputes arising out of their contract they thereby intend to "waive" all of the various Constitutional and public policy protection afforded by the law in the absence of any express wording to that effect.

In this case, the award of punitive damages by the arbitrators violated the requirements of the Due Process Clause of the United States Constitution and the Due Course of Law provision of the Texas Constitution. As such, the Trial Court's decision to modify the Award to eliminate the punitive damages purportedly imposed on O'Quinn was correct because the award of punitive damages violated the Due Process Clauses of the United States and Texas Constitutions. *See, **Oberg***, 62 U.S.L.W. at 4631. Accordingly, O'Quinn requests that this Court reverse the Opinion of the Court of Appeals and affirm the Judgment of the Trial Court.

**C. Arbitrators should not be permitted to award punitive damages as a matter of public policy: (Germane to Points of Error No. 7, 8 & 9)**

Even if this Court concludes that arbitration proceedings are constitutionally acceptable, this Court should hold that public policy considerations prohibit arbitrators from awarding punitive damages, at least unless the parties have otherwise expressly agreed. In ***Garrity v. Lyle Stuart, Inc.***, 353 N.E.2d 793 (N.Y. 1976), the New York Court of Appeals examined this precise issue. The *Garrity* Court held, not on constitutional grounds, but as a matter of public policy, that an arbitrator has no power to award punitive damages, even if the parties had attempted to bestow that power on the arbitrator. The court held that punitive damages is a sanction reserved to the state, a public policy of such magnitude as to call for judicial intrusion to prevent its contravention. ***Id.*** at 794. Because enforcement of an award of punitive damages as a purely private remedy would violate strong public policy, the New York Court of Appeals held that an arbitrator's award which imposes punitive damages should be vacated. ***Id.*** at 794.

The factors considered by the New York Court of Appeals which constituted the bases for its conclusion were:

> (1) At common law, punitive damages are available only in a limited number of instances. Punitive damages are allowed in cases where the wrong complained of is morally culpable, or is actuated by evil and reprehensible motives, not only to punish the defendant, but to deter him, as well as others who might otherwise be so prompted, from indulging in similar conduct in the future. It is a so-called exemplary "remedy," not a private compensatory remedy. ***Id.*** at 795.
>
> (2) Punitive damages are not available for mere breach of contract, for in such a case, only a

private wrong and not a public right is involved. *Id.* at 795. Even if there was a so-called "malicious" breach of the contract, that would not permit the imposition of punitive damages. Punitive sanctions are reserved to the State. This is a public policy of such magnitude as to call for judicial intrusion. *Id.* at 796.

(3) The evil of permitting an arbitrator, whose selection is often restricted or can be manipulated by the party in a superior bargaining position, to award punitive damages is that it displaces the court and the jury, and therefore the State, as the engine for imposing a social sanction. Actual damages are measurable against some objective standard. But punitive damages take their shape from the subjective criteria involved in attitudes toward correction and reform, and courts do not readily accept the delegation of that kind of power. Where punitive damages have been allowed for those torts which are still regarded somewhat as public penal wrongs, as well as actionable private wrongs, they have rather close judicial supervision. *Id.* at 796.

(4) Standards, such as whether the award of punitive damages was irrational or unjust, are subjective and afford no practical guidelines for the arbitrator and little protection against abuse. Moreover, even if such standards were imposed on the arbitration proceeding in an effort to install fairness to the system, the imposition of the standards would be contrary to the sound development of arbitration law. *Id.* at 796.

(5) The parties to arbitration agree to the substitution of a private tribunal for purposes of deciding their disputes without the expense, delay, and rigidities of traditional courts. If arbitrators are allowed to impose punitive damages, the usefulness of

arbitration will be destroyed. It will become a trap for the unwary, given the eminently desirable freedom from judicial overview of law and facts. It would mean that the scope of the determination by arbitrators, by the license to award punitive damages, would be both unpredictable and uncontrollable. *Id.* at 796.

(6) In imposing penal sanctions in private arrangements, a tradition of the rule of law in organized society is violated. One purpose of the rule of law is to require that the use of coercion be controlled by the State. In a highly developed commercial and economic society, the use of private force is not the danger, but the uncontrolled use of coercive economic sanctions in private arrangements is. The power to punish is a monopoly of the State and not that of any private individual. *Id.* at 796-797.

(7) The parties usually never agreed, or, for that matter, even consider punitive damages as a possible sanction for breach of an agreement. Even if the parties had sought to agree that the arbitrators could award punitive damages, the law does not and should not permit private persons to submit themselves to punitive sanctions of the order reserved to the State. The freedom of contract does not embrace the freedom to punish, even by contract. *Id.* at 797.

(8) Under common law principles, there is eventual supervision of jury awards of punitive damages, in the singularly rare cases where they are permitted, by the trial court's power to change awards and by the appellate court's power to modify such awards.

Other states have adopted this same holding for public policy reasons. For example, in ***Shaw v. Kuhnel & Associates,***

*Inc.*, 698 P.2d 880, 881 (N.M. 1985), the Supreme Court of New Mexico held, citing ***Garrity***, that an Arbitrator should not be given authority to award punitive damages; this power is reserved to the Courts. In ***United States Fidelity & Guaranty Co. v. DeFluiter***, 456 N.E.2d 429 (Ind. Ct. App. 1983), the Indiana Court of Appeals held that because arbitration arises out of a contractual relationship, punitive damages are unavailable because parties may not contract to benefit from or be penalized by punitive damages. ***Id.*** at 432. *See also*, ***School City of East Chicago, Indiana v. East Chicago Federation of Teachers***, 422 N.E.2d 656, 663 (Ind. Ct. App. 1981).

The Trial Court's decision to modify the Award to eliminate the punitive damages purportedly imposed on O'Quinn was correct because the award of punitive damages violates important public policy concerns of the State of Texas. The policy concerns recognized by New York's highest court are just as true in Texas as they are in New York. Just as the New York Court of Appeals recognized, parties agree to arbitration for purposes of deciding their disputes without the expense, delay, and rigidities of traditional courts. If arbitrators are allowed to impose punitive damages, the usefulness of arbitration will be destroyed. It will mean, just as the New York Court of Appeals predicted, that the scope of the determination by arbitrators, by virtue of the license to award punitive damages, will become unpredictable and uncontrollable. Indeed, if arbitrators can award punitive damages without even the judicial supervision over jury awards of punitive damages, and without the judicial review required with respect to jury awards, contracting parties will seek to avoid arbitration. On the other hand, if as a matter of public policy Arbitrators are not allowed to award punitive damages, arbitration will become an even more effective and favored means for resolving disputes between contracting parties.

## III. The Court of Appeals erred in holding that the arbitrators were authorized to award punitive damages: (Germane to Point of Error Nos. 1, 9, 10, 11, 12, 13 & 14)

### A. Arbitrators must act within the limitations imposed by the parties' agreement and the law (Germane to Points of Error Nos. 1, 10 & 11):

All arbitration proceedings in this State, whether conducted pursuant to the common law, the Texas General Arbitration Act, or the Federal Arbitration Act, arise out of consensual understandings. Article 224 of the Texas General Arbitration Act makes it clear that a written agreement is required to compel parties to arbitrate their disputes and the terms of the written agreement govern which disputes are submitted to arbitration. TEX. REV. CIV. STAT. ANN. art 224 (Vernon Supp. 1993). Because arbitration provisions are in derogation of a right of trial by jury, arbitration is not extended beyond the terms of the contract or to issues and matters not covered thereby. *See, e.g.,* ***Seale v. Roy M. Mitchell Contracting Co.***, 321 S.W.2d 149, 150 (Tex. Civ. App.--Austin 1959, writ ref'd). Texas courts consistently hold that the parties must have *specifically agreed* to arbitrate the particular matter in dispute. *See, e.g.,* ***Valero Energy Corp. v. Wagner & Brown***, 777 S.W.2d 564, 566 (Tex. App.--El Paso 1989, writ denied). Similarly, the United States Supreme Court has admonished that "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed to submit." ***United Steelworkers v. Warrior & Gulf Navigation Co.***, 363 U.S. 574, 582 (1960).

Although it is often assumed that an arbitration award is entitled to great deference by the courts, this assumption is untrue with respect to the authority and jurisdiction of the arbitrators. An arbitrator's decision as to the scope of his authority is subject to the scrutiny of the courts to ensure that the arbitrator acted properly. *E.g.,* ***E. I. Du Pont de Nemours & Co. v. Local 900***, 968 F.2d 456, 458 (5th Cir. 1992); ***Babcock &***

*Wilcox Co. v. PMAC, Ltd.*, 863 S.W.2d 225, 230 (Tex. App.--Houston [14th Dist.] 1993, writ denied).

The Texas General Arbitration Act provides for the determination of whether the arbitrators exceeded their authority or awarded on a matter not submitted, at least to the extent of determining whether the arbitrators acted within the bounds of their authority. Article 237 requires that an award be vacated when the arbitrators exceed their authority and Article 238 requires the modification or correction of an award when the arbitrators make an award on a matter not submitted to them. TEX. REV. CIV. STAT. ANN. arts. 237 & 238 (Vernon 1973). Review of the award is so important that, even where the parties expressly waive the right to judicial review of an arbitration award, the courts still have the authority to review the award under Articles 237 and 238. *Grissom v. Greener & Sumner Constr., Inc.*, 676 S.W.2d 709, 711 (Tex. App.--El Paso 1984, writ ref'd n.r.e.).

**B. Kline's own pleadings and demand for arbitration show that she did not submit the issue of punitive damages to the arbitrators (Germane to Points of Error Nos. 1, 10, 11, 12, 13 & 14):**

Due Process of law applies in arbitration proceedings just as in other legal proceedings. O'Quinn was entitled to fair notice of the claims made against him. By letter of May 28, 1991 from Kline's counsel to Ms. Tamme S. Wilkes of the American Arbitration Association, Kline's counsel transmitted the Original Petition to the American Arbitration Association as the definition of Kline's claim. In her Original Petition, Kline alleged breach of contract, breach of an alleged tort duty of good faith, and breach of an alleged fiduciary duty. Kline pled and prayed only for actual damages, *i.e.*, economic losses. Kline did not plead or pray for exemplary damages. Indeed, there is no mention -- not one single word -- in the Original Petition about exemplary damages.

Moreover, Kline did not plead the existence of a separate and distinct tort that caused separate actual damages in tort. Each of these elements is required by Texas law before a claimant can recover punitive damages. Lawyers who are trained to recognize the necessary elements of a claim for punitive damages simply could not have known from Kline's pleadings that she was thinking about attempting to recover punitive damages. The law does not require them to guess as what Kline might be secretly planning.

The Texas General Arbitration Act, however, requires the courts to modify or correct an award if the arbitrators issue an award on "a matter not submitted to them..." TEX. REV. CIV. STAT. ANN. art. 238(A)(2). Both the Fourteenth Court and the Texas Supreme Court have considered the writings submitted by the parties to the Arbitrators in determining the scope of the matters submitted to arbitration. *See* ***USX Corp. v. West***, 781 S.W.2d 453, 455 (Tex. App.--Houston [14th Dist.] 1989, no writ) (considering papers submitted to the American Arbitration Association); ***Gulf Oil Corp. v. Guidry***, 327 S.W.2d 406, 407-11 (Tex. 1959) (considering various papers and correspondence among the arbitrators). Hence, Kline's statement of her claims via her submissions to the arbitrators is extremely important.

The Trial Court found that the issue of punitive damages was not submitted to the arbitrators. [Tr. 380] Both ***USX*** and ***Gulf Oil*** make it clear that the Trial Court properly considered Kline's submissions to the AAA. In the absence of a transcript of the arbitration proceedings, a reviewing court should defer to the Trial Court on the question of whether, despite Kline's submissions, the parties nonetheless submitted the issue of punitive damages to arbitration. Despite the Fourteenth Court's statement to the contrary, it need not follow ***House Grain Co. v. Obst***, 659 S.W.2d 903, 906 (Tex App.--Corpus Christi 1983, writ ref'd n.r.e.), and "presume adequate evidence to support the award." As pointed out in Justice Ellis' dissent below, ***Obst*** created this supposed presumption without any supporting authority from this Court. Moreover, ***Gulf Oil***

(which was decided by this Court) suggests that the Texas courts should consider various papers, including correspondence, to determine whether a particular issue was submitted to arbitration and whether the arbitrators exceeded their authority. ***Gulf Oil***, 327 S.W.2d at 407-11.

Finally, it is important to note that the appellant -- in this case Kline -- generally bears the risk of having an inadequate record. *See* ***Christiansen v. Prezelski***, 782 S.W.2d 842, 843 (Tex. 1990); TEX. R. APP. P. 50(d). Hence, if an appellant (such as Kline) fails to present a complete statement of the facts, the appellate court cannot properly determine that the Trial Court's ruling was incorrect. *See id.*, 782 S.W.2d at 843-44. In the past, the Court of Appeals had emphasized that the appellant, not the appellee, bears the burden of submitting an adequate record to reverse the trial court's handling of an arbitration award. ***Atrium Westwood VIII Venture v. Barrick Westwood L.P.***, 693 S.W.2d 699, 700-01 (Tex. App.--Houston [14th Dist.] 1985, no writ). Accordingly, the Fourteenth Court's presumption of evidence to support the award, a presumption which runs contrary to Kline's own submission to the AAA and ***Westwood*** was in error. This Court should rely on Kline's submissions to the arbitrators and defer to the Trial Court's findings.

**C. The parties' agreement precluded the submission of the question of punitive damages (Germane to Points of Error Nos. 1, 10 & 11) :**

The dispute submitted to the arbitrators arose out on a written agreement among Kline, O'Quinn and Pearson relating to the apportionment of legal fees received from several cases. In this agreement, there was an arbitration provision which provides as follows:

> In the event that a dispute arises among Parties that cannot be amicably resolved or, Parties have elected to terminate this Agreement and are unable to reach

> an agreement to that end, said dispute shall be determined by arbitration conducted in the City of Houston, State of Texas, in accordance with the rules then in force of the American Arbitration Association. [Tr. 34]

By this agreement, O'Quinn, Kline and Pearson did not expressly, or even by implication, grant authority to the Arbitrators to award exemplary damages in connection with disputes arising out of an alleged breach of the contract in dispute.

This arbitration provision is fairly narrow -- it avoids the broad terminology frequently found in arbitration provisions that the parties submit "any and all claims, demands, disputes, controversies, or other matters pertaining to the written agreement in issue, whether or not arising independently out of the written agreement, and whether in contract, tort or otherwise." *See* ***Babcock & Wilcox***, 863 S.W.2d at 230 (listing several examples of broad arbitration clauses, each of which starts with "any dispute" or the like). The use of the narrow arbitration provision in the agreement among Kline, O'Quinn, and Pearson thus demonstrates that the parties intended for the arbitrators to resolve contractual disputes, not to award exemplary damages for alleged activities outside the scope of the contract.

Despite the Fourteenth Court's view that the arbitration clause is broad, it is quite similar to the one at issue in ***Central Texas Clarklift, Inc. v. Simmons***, 540 S.W.2d 745, 746-47 (Tex. Civ. App.--Waco 1976, no writ). That case involved the following arbitration clause:

> Upon the occurrence of a dispute relative to any provision of this Agreement or the application of any provision of this Agreement or if a price determination is required by any Paragraph herein, the same shall be submitted to arbitration under the terms and conditions of the "Texas General Arbitration Act."

540 S.W.2d at 746. In ***Simmons***, the plaintiff had sold a business. As part of the sale contract, Simmons also agreed to a covenant not to compete. When the buyer learned of Simmons' new employment with Trans Lift, the buyer sent letters and made telephone calls to Trans Lift asserting that Simmons was violating the covenant not to compete. 540 S.W.2d at 746. Simmons sued the buyer for tortious interference. The court of appeals held that the claim for tortious interference was not within the scope of the above arbitration clause, as the alleged intentional tort was not a dispute relating to the contract. ***Id.*** at 747.

The arbitration provision in the contract among Kline, O'Quinn and Pearson was clearly no broader than that at issue in ***Simmons***. Moreover, the arbitration clause in this case clearly did not authorize the arbitrators to award punitive damages for activities for which punitive damages may not be awarded under Texas law, *i.e.*, for breach of contract. In this case, as discussed below, the only alleged activities that could have possibly given rise to punitive damages would have been activities outside the agreement. As in ***Simmons***, the arbitration provision between O'Quinn and Kline did not specifically authorize the arbitrators to award punitive damages for outside-the-contract activities. Because of the unique and harsh nature of punitive damages, it is unrealistic to assume that the parties intended the arbitration provision to authorize the arbitrators to award punitive damages for outside-the-contract activities and to waive their Due Process rights to judicial review and other common law safeguards.

While the issue is not settled in Texas, the El Paso Court of Appeals has held that the arbitrators have the power to award punitive damages -- where the parties have ***expressly*** submitted the issue to the arbitrators. ***Grissom v. Greener & Sumner Constr., Inc.***, 676 S.W.2d 709, 711 (Tex. App. -- El Paso 1984, writ ref'd n.r.e.). But the ***Grissom*** decision is not applicable here because the parties here did not expressly submit the issue to the arbitrators. It is respectfully that, as a matter of law, arbitrators should not be allowed to award

punitive damages unless the parties have specifically and expressly granted that authority to the arbitrators. *See, e.g.,* ***International Union of Operating Engineers v. Mid-Valley, Inc.***, 347 F. Supp. 1104, 1108-10 (S.D. Tex. 1972).

In its Opinion, the Court of Appeals relied heavily on ***USX Corp. v. West***, 781 S.W.2d 453 (Tex. App. -- Houston [1st Dist.] 1989, no writ). In ***USX***, the First Court refused to mandamus Judge David West to require him to grant a motion to compel arbitration because he had already granted a motion to stay pending arbitration. ***USX***, 781 S.W.2d at 454-56. In effect, the court reviewed the pleadings and submissions to the arbitrators, concluding that they were sufficient to submit various contract and tort claims, and various types of damages, to the arbitrator. The court then left it to the parties and the arbitrator to address pleading issues. ***Id.*** at 456-57.

Significantly, however, the ***USX*** case did not address the basic question of whether an award of punitive damages is constitutional or otherwise prohibited by public policy. Similarly, the ***USX*** case did not address the applicability of the express consent rule. Moreover, the ***USX*** case did not address questions involving the determination of what was submitted to arbitration; instead ***USX*** involved what should be submitted. Deference in favor of arbitration at the early stages of a dispute makes sense, as it seems likely to further the use of arbitration. After an arbitration proceeding is concluded, however, the Texas General Arbitration Act requires the consideration of what was submitted and whether the arbitrators exceeded their authority. *See* ***Life of Am. Ins. Co. v. Aetna Life Ins. Co.***, 744 F.2d 409, 412-413 (5th Cir. 1984) (deferring decision on arbitrators' authority to award treble damages under Texas Insurance Code until after arbitration proceeding).

**D. The Trial Court's judgment should be affirmed because the arbitrators exceeded their authority and awarded on a matter not submitted (Germane to Points of Error Nos. 10, 11 & 12):**

The Court of Appeals incorrectly avoided the issue of whether the arbitrators exceeded the scope of their authority. *See* Op. at 6. Instead of addressing this alternative basis for affirming the Trial Court, the Court of Appeals observed that the Trial Court only modified the award, implying that the Trial Court's finding that the arbitrators exceeded their authority is irrelevant. In fact, this finding (which was not rejected by the Fourteenth Court) means that the Judgment should be affirmed. *See, e.g.*, ***Mid-Valley***, 347 F. Supp at 1108-10 (vacating punitive damages award as exceeding the scope of the arbitrator's authority).

As the Fourteenth Court correctly noted, Article 237 provides for vacating an award when the arbitrators exceed their authority. Article 238 provides for modification and correction when the arbitrators have awarded on a matter not submitted to them. *See* TEX. REV. CIV. STAT. ANN. art. 237 & 238. Nonetheless, there will be few, if any, cases where the arbitrators may award on a matter not submitted, yet still act within their authority. This is because all arbitration derives its authority from the parties' agreement. Consequently, there is a great deal of overlap between Articles 237 and 238 -- they are not mutually exclusive, as the Court of Appeals suggested.

The Texas courts may modify a part of an award if that portion is outside the arbitrators' authority. In ***Smith v. Barnett***, 373 S.W.2d 762, 765-66 (Tex. Civ. App.--Dallas 1963, no writ), the court modified an award to delete an incorrect amount of interest. The court viewed the mistake as not due to the arbitrators, yet held that even if the arbitrators exceeded their authority, the incorrect amount "could be disregarded as mere surplusage, and the remainder of the award left standing." ***Id.*** at 766. As in ***Smith***, the Fourteenth Court should have

affirmed the Trial Court's Judgment to delete the portion of the award which exceeded the arbitrators' authority. Hence, the Court of Appeals erred when it reversed the Trial Court's Judgment setting aside the punitive damages portion of the award.

**E. The Fourteenth Court's Opinion incorrectly addressed the arbitrators' authority on *procedural* questions instead of reviewing the award pursuant to Articles 237 and 238 (Germane to Points of Error Nos. 12 & 13):**

As noted, Articles 237 and 238 require the Texas courts to review arbitration awards if the review is timely requested. TEX. REV. CIV. STAT. ANN. arts. 237 & 238. Various grounds for review are specified in Articles 237 and 238. O'Quinn timely requested review of the award.

Despite the plain wording of Articles 237 and 238, the Fourteenth Court's Opinion essentially ignored the relevance of Kline's submissions to the arbitrators. *See* Op. at 8-10. In fact, Kline's demand for arbitration and other papers submitted to the arbitrators are the most important record of which issues were submitted to arbitration. *See* ***USX Corp v. West***, 781 S.W.2d 453 (Tex. App.--Houston [1st Dist.] 1989, no writ) (considering pleadings and submissions to arbitrators). As detailed below, Kline never submitted the question of punitive damages to arbitration. Under Article 238(A)(2), the Trial Court was therefore required to modify the award to delete the award of punitive damages.

In its opinion, the Court of Appeals cited ***USX, John Wiley & Sons, Inc. v. Livingston***, 376 U.S. 543 (1964), and ***Del E. Webb Constr. v. Richardson Hosp. Auth.***, 823 F.2d 145 (5th Cir. 1987), for the proposition that procedural questions involving a dispute in arbitration should be left to the arbitrators. The "procedural questions" at issued in ***John Wiley*** and ***Del Webb***, however, dealt only with the procedures the parties were required to follow prior to invoking arbitration. In ***John Wiley***, the Court considered an agreement that required (1) a conference among an employee, a union representative, and an officer of the employer and (2) a conference among an officer of the employer, the union shop committee and/or a union

representative *before* the parties initiated arbitration. 376 U.S. at 555-56. Similarly, ***Del Webb*** involved "contractual prerequisites for demanding arbitration," although the Fifth Circuit did not state just what these were. *See* 823 F.2d at 146 & 149-150.

In the arbitration clause at issue here, the parties were to "endeavor in good faith to resolve the dispute amicably" before resorting to arbitration. *See* Op. at 7. Whether or not they met this requirement would be a "procedural question" for the arbitrators under ***John Wiley*** and ***Del Webb***. However, that question is not at issue in this case. Instead of such a "procedural question," this case involves the scope of the arbitrators' authority and whether punitive damages were submitted to the arbitrators.

A close reading of ***USX*** shows that it actually supports O'Quinn's position. As detailed below, ***USX*** dealt primarily with the question of whether a trial court was required to *compel* arbitration after it had already stayed the case pending arbitration. *See* 781 S.W.2d at 454-56. In ***USX***, Energy Buyers filed suit, claiming both actual damages and punitive damages. ***Id.*** at 454 & 456. Unlike Kline, Energy Buyers clearly requested punitive damages. Moreover, Energy Buyers requested "damages" in its answer filed with the arbitrators. ***Id.*** at 455. With respect to the question of whether Energy Buyer's papers were sufficient or a clearer statement was required, the court observed that such matters were for the arbitrators. ***Id.*** at 456. The ***USX*** court did not consider the issue of the appropriate level of review by the courts <u>after</u> an award has been issued.

Unlike ***USX***, Kline's court pleadings failed to request punitive damages. Hence, there was no potential conflict between what Kline sought from the court versus what she sought from the arbitration, as was the case in ***USX***. Instead, Kline's submissions to the arbitrators made it quite clear that she was seeking actual damages, <u>not</u> punitive damages. Other courts have refused to allow arbitrators to award punitive

damages where such relief was not requested from the outset. *See* ***Hotel & Rest. Employees & Bartenders Int'l Union v. Michelson's Food Serv., Inc.***, 545 F.2d 1248, 1254 (9th Cir. 1976).

## IV. Kline was not entitled to punitive damages (Germane to Points of Error Nos. 1 & 9):

This case illustrates a key problem with arbitration -- the arbitrators may, either inadvertently or intentionally, enter an award clearly contrary to the law, yet that award might be upheld. Even the Fourteenth Court held that O'Quinn owed no fiduciary duty to Kline. Op. at 17-18. Moreover, Justice Ellis clearly pointed out that O'Quinn owed no tort duty of good faith and fair dealing. Op. at 4-5. The only other claim submitted to arbitration was Kline's contract claim. As detailed below, Texas law clearly prohibits an award of punitive damages for mere breach of contract. But that is exactly the result of the Court of Appeals' Opinion.

### A. Under Texas law, there are special rules applicable to punitive damages:

In addition to failing to plead and pray for exemplary damages and thus failing to submit the issue of punitive damages to the arbitrators, there is another important reason why Kline may not recover exemplary damages. Texas law simply does not allow the recovery of punitive damages for breach of contract, even if the breach is intentional, willful, and malicious. *See, e.g.,* ***Manges v. Guerra***, 673 S.W.2d 180, 184 (Tex. 1984); ***Amoco Prod. Co. v. Alexander***, 622 S.W.2d 563, 571 (Tex. 1981). Because plaintiffs continually attempt to side-step this rule by clever pleading, this Court has established the rule that a complainant's ability in Texas to recover exemplary damages in connection with a breach of contract claim is subject to special rules and requirements. The Court has held that in order to recover punitive damages attendant to a contract dispute a claimant must both (1) plead and (2) prove: (a) the commission of a separate tort, and (b) that the claimant

sustained separate actual damages as a result of that separate tort. See, e.g., ***International Bank, N.A. v. Morales***, 736 S.W.2d 622, 624 (Tex. 1987); ***Texas Nat'l Bank v. Karnes***, 717 S.W.2d 901, 903 (Tex. 1986); ***Jim Walter Homes, Inc. v. Reed***, 711 S.W.2d 617, 618 (Tex. 1986); ***Bellefonte Underwriter's Ins. Co. v. Brown***, 704 S.W.2d 742, 745 (Tex. 1986).

Simply alleging, as Kline did, that the defaulting party to a contract allegedly also breached some tort duty, *e.g.*, fiduciary duties or an implied duty of good faith and fair dealing, will not suffice. There must also be pleading and proof that the separate and distinct tortious conduct caused the claimant to sustain separate and distinct actual damages in tort. It is only the separate actual damages in tort that will support a claim for exemplary damages. *See, e.g.,* ***International Bank***, 736 S.W.2d at 624; ***Texas Nat'l Bank***, 717 S.W.2d at 903; ***Jim Walter Homes***, 711 S.W.2d at 618; ***Bellefonte Underwriter's Ins. Co.***, 704 S.W.2d at 745.

In a further attempt to side-step these requirements, plaintiffs frequently argue that their economic losses in fact are their required "tort" damages. This Court has rejected this argument. This Court has established the doctrine that if the actual damages sustained by the claimant are economic losses arising out of breach of the contract involved in the litigation, then no matter how the complainant disguises or characterizes her so-called tort claims, the dispute is simply one of breach of contract. *See, e.g.,* ***Crim Truck & Tractor Co. v. Navistar***, 823 S.W.2d 591, 594-95 (Tex. 1992); ***Southwestern Bell Telephone Co. v. FDP Corp.***, 811 S.W. 2d 572, 577 (Tex. 1991); ***Southwestern Bell Telephone Co. v. Delaney***, 809 S.W.2d 493, 495 (Tex. 1991); ***International Bank***, 736 S.W.2d at 624; ***Texas Nat'l Bank***, 717 S.W.2d at 903; ***Jim Walter Homes***, 711 S.W.2d at 618; ***Bellefonte Underwriter's Ins. Co.***, 704 S.W.2d at 745; and ***Amoco Prod. Co.***, 622 S.W.2d at 571.

In this case, there was no pleading of separate tortious conduct by O'Quinn that caused separate actual damages in tort to Kline. Kline alleged that she sustained economic losses

resulting from alleged breach of contract. Kline claimed she was entitled to monies owed to her under the contract, plus interest. The Award of actual damages made her whole. But then Kline presented the conclusory rhetoric commonly found in pleadings of this nature, the rhetoric which this Court has consistently held gives rise only to a claim for breach of contract. Kline made the conclusory allegations that O'Quinn breached an alleged duty of good faith and breach an alleged fiduciary duty. But, even if such allegations were true, which is denied, Kline did not plead and prove any separate actual damages in tort (*e.g.*, mental anguish, etc.) caused by the alleged tortious conduct. Thus, while these other extraneous allegations may sound bad (in fact, that is why plaintiffs usually add them into their petition when suing on a contract), they do not convert the case into a tort dispute and they will not support an award of punitive damages.[6]

Unfortunately, there is no transcript of the arbitration proceeding. Hence, this Court must rely on the pleadings and other submissions in order to determine what was submitted to the arbitrators. Although Kline suggested below that it is somehow O'Quinn's fault that there is no transcript, Kline also failed to seek a transcript. As detailed above, the Trial Court properly relied on Kline's submissions to the AAA to define her claims.

**B. Kline also failed to plead and prove the type of intentional conduct necessary to support an award of punitive damages:**

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[6] In most situations where a plaintiff is suing on a contract and is also attempting to recover exemplary damages, the plaintiff at least pleads that he or she is seeking exemplary damages. This at least gives the defendant fair notice of the plaintiff's intentions. But here Ms. Kline not only failed to plead and prove separate actual damages in tort to support an award of exemplary damages -- but did not even plead or pray for exemplary damages at all!

Assuming that Kline had actually pled and proved separate actual damages in tort sustained as a result of breach of an alleged duty of good faith and fair dealing and/or an alleged fiduciary duty, she still would not be entitled to punitive damages. A breach of the duty of good faith and fair dealing by itself does not entitle the injured party to punitive damages. A breach of a fiduciary duty by itself does not entitle the injured party to punitive damages. In order to recover exemplary damages for breach of the duty of good faith and fair dealing or breach of fiduciary duty, a complainant must also plead and prove and obtain the additional finding of fraud, malice, or gross negligence. *See* TEX. CIV. PRAC. & REM. CODE § 41.003 (Vernon Supp. 1993); ***Burk Royalty Co. v. Walls***, 616 S.W.2d 911, 922 (Tex. 1981) (addressing the issue of exemplary damages in general); ***Arnold v. Nat'l County Mutual Fire Ins. Co.***, 725 S.W.2d 165, 168 (Tex. 1987) (addressing the issue of exemplary damages in connection with claim of a breach of a duty of good faith and fair dealing); ***Manges v. Guerra***, 673 S.W.2d 180, 184 (Tex. 1984) (addressing the issue of exemplary damages in connection with a claim of breach of fiduciary duty). Because Kline did not plead or prove this additional element, she was never entitled to an award of exemplary damages for breach of the alleged torts of good faith and fair dealing and/or fiduciary duty. Hence, the Final Judgment should be affirmed.

**V. Conclusions:**

In this case, although the magnitude of the punitive damages was relatively small, Constitutional Due Process was violated by lack of notice. Moreover, none of the Constitutional safeguards required by the United States and Texas Supreme Courts with respect to the award of punitive damages, and the subsequent review of a punitive damages award, are found in an arbitration proceeding. For constitutional and public policy reasons, arbitrators should not be allowed to award punitive damages -- particularly in situations where the parties have not expressly authorized them to do so and thereby in effect waived their constitutional rights.

If this Court allows arbitrators in situations such as this to award punitive damages where the claimant did not seek punitive damages, and there was no notice that punitive damages might be in issue in the Arbitration Proceeding, and Texas law does not allow the award of punitive damages under the facts of this dispute, and there are no Constitutional safeguards, all legal principles and the Constitutional safeguards applicable to the award of punitive damages will be circumvented through the arbitration process.

This is a case in which the claimant did not properly lodge a claim for punitive damages. Kline's failure to request punitive damages in her pleadings demonstrates that the parties never intended to allow the arbitrators to award punitive damages. She sought only economic losses for breach of contract. It was only after the close of evidence that Kline's counsel (obviously believing he had successfully attacked O'Quinn) asked for such damages. Kline made this belated request even though Texas law does not allow the recovery of punitive damages under these circumstances. The Arbitrators, completely contrary to well-settled Texas law, nevertheless attempted to award such damages. This action by the Arbitrators exceeded their authority. The Trial Court was correct in vacating the portion of the Award where the Arbitrators exceeded their authority.

*Contracting* parties elect to submit their disputes to arbitration for the purpose of a private, speedy and fair resolution, without the delays and rigidities of a court trial. They expect the arbitration of their *contractual* disputes arising out of the contract. They do not expect the arbitrators to award punitive damages, particularly when the law does not allow the recovery of punitive damages for breach of contract.

It is one thing for contracting parties to submit to arbitration the issue of contractual compensatory damages, which are largely based on objective criteria. But punitive damages are entirely different. They are subjective and, as the New York Court of Appeals noted in ***Garrity***, take their shape

from attitudes towards correction and reform. Because the award of punitive damages is so subjective, supervision by the courts is required. The need for supervision is heightened in arbitration proceedings because of the abbreviated discovery in arbitration (which can function to deny the defendant from developing the facts necessary to refute the plaintiff's allegations), the fact that arbitrators historically do not adhere to the rules of evidence and are willing to listen to anything, no matter how irrelevant, emotional and prejudicial, and because of the extremely judicial review of arbitration awards.

Because one of the underlying theories of arbitration is that there should be minimal court review and supervision, allowing arbitrators to award punitive damages will lead to unpredictable, uncontrolled, and non-reviewable awards of punitive damages. This violates public policy concerns of the State and fails to comply with the requirements of the United States and Texas Constitutions. Should this Court conclude that policy and constitutional concerns do not require barring arbitrators completely from awarding punitive damages, those same concerns require that at the very least arbitrators may not award punitive damages except where the contracting parties have expressly granted them the authority to do so. Here the narrowly drawn contractual arbitration provision did not authorize the arbitrators to award punitive damages. The Trial Court's *Final Judgment* in this case eliminating the award of punitive damages against O'Quinn was entirely correct because the arbitrators were not authorized to award punitive damages.

O'Quinn respectfully urges that the Court grant a Writ of Error, reverse the decision of the Court of Appeals, and affirm the Trial Court's *Final Judgment*.

Respectfully submitted,

/s/ J. Clark Martin
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ATTORNEYS FOR PETITIONER
JOHN M. O'QUINN

## CERTIFICATE OF SERVICE

I hereby certify that a copy of this *APPLICATION FOR WRIT OF ERROR OF PETITIONER JOHN M. O'QUINN* was served upon each of Donna C. Kline, Thomas J. Pearson, and Bank One, Texas, N.A., by mailing a copy of same via certified mail, return receipt requested, to their respective counsel of record as follows:

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This 25th day of July, 1994.

/s/ J. Clark Martin

**APPENDIX N**

NO. 94-0780

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JOHN M. O'QUINN,
Petitioner,

vs.

DONNA C. KLINE,
Respondent

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IN THE TEXAS SUPREME COURT

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MOTION FOR REHEARING ON APPLICATION
FOR WRIT OF ERROR OF PETITIONER
JOHN M. O'QUINN

---

TO THE SUPREME COURT OF TEXAS:

COMES NOW Petitioner John M. O'Quinn ("O'Quinn") and respectfully files this Motion for Rehearing of his Application for Writ of Error. For the reasons set forth below, O'Quinn prays that this Court grant this Motion and, upon rehearing, grant his Application for Writ and ***reverse*** the decision of the Court of Appeals and ***affirm*** the Final Judgment of the Trial Court.

For the reasons detailed in his Application for Writ of Error, which was filed on July 25, 1995, and is hereby incorporated fully by reference, Petitioner O'Quinn respectfully

requests rehearing on his Application for Writ of Error. The Points relied upon by O'Quinn are as follows:

1. This Court erred by not reversing the Court of Appeals' modification of the Final Judgment to include punitive damages from the arbitration award. (Op. at 6-12.)

2. This Court erred by not reversing the Court of Appeals' holding that certain aspects of O'Quinn's Constitutional arguments were waived. (Op. at 11.)

3. This Court erred by not reversing the Court of Appeals' holding that the arbitration award of punitive damages may be affirmed without violating the United States or Texas Constitutions. (Op. at 11.)

4. This Court erred by not reversing the Court of Appeals' holding that the arbitration award of punitive damages may be affirmed without violating the United States or Texas Constitutions because arbitration proceedings in general lack the necessary safeguards required by the United States and Texas Constitutions for arbitrators to award punitive damages, even if the parties attempt to specifically bestow that right upon the arbitrators. (Op. at 11.)

5. This Court erred by not reversing the Court of Appeals' holding that the arbitration award of punitive damages may be affirmed without violating the United States or Texas Constitutions because arbitration proceedings in general lack the necessary safeguards required by the United States and Texas Constitutions for arbitrators to award punitive damages and thus arbitrators may not award punitive damages unless the parties have clearly and expressly waived their Constitutional rights by authorizing the arbitrators to award punitive damages. (Op. at 11.)

6. This Court erred by not reversing the Court of Appeals' holding that the arbitration award of punitive damages

may be affirmed without violating the United States or Texas Constitutions because the arbitration proceedings as conducted denied O'Quinn Due Process of law. (Op. at 11.)

7. This Court erred in failing to adopt and apply as the public policy of Texas a rule that prohibits arbitrators from awarding punitive damages even when the parties attempt to grant the arbitrators the authority to award such relief. (Op. at 11-12.)

8. This Court erred in failing to adopt and apply as the public policy of Texas a rule that prohibits arbitrators from awarding punitive damages unless the parties have specifically and expressly agreed to give the arbitrators the authority to award such relief. (Op. at 11-12.)

9. This Court erred by not reversing the Court of Appeals' decision to reverse the Trial Court and then award punitive damages because there is no legal basis for an award of punitive damages in this case. (Op. 6-12 & 14-18.)

10. This Court erred by not reversing the Court of Appeals' conclusion that the parties contemplated the arbitration of tort claims and especially claims for punitive damages. (Op. 7-10.)

11. This Court erred by not reversing the Court of Appeals' conclusion that the award of punitive damages was within the scope of the arbitrator's authority. (Op. at 6-10.)

12. This Court erred by not reversing the Court of Appeals' conclusion that the arbitrators could have found that Kline's pleadings were sufficient to state a claim for punitive damages. (Op. at 8-10).

13. This Court erred by not reversing the Court of Appeals' presumption that the evidence before the arbitrators supported an award of punitive damages. (Op. at 10.)

14. This Court erred by not reversing the Court of Appeals' holding that, as the losing party in arbitration, Mr. O'Quinn was required to bring forward to the Trial Court a complete record and all bases for vacating or modifying the Arbitration Award. (Supp. Op. at 2.)

In conclusion, Mr. O'Quinn respectfully urges that the Court grant this Motion for Rehearing and, upon rehearing, grant the Application for a Writ of Error, reverse the decision of the Court of Appeals, and instead affirm the Trial Court's *Final Judgment*.

Respectfully submitted,

/s/ J. Clark Martin by Eva C. Ramos

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ATTORNEYS FOR PETITIONER
JOHN M. O'QUINN

## CERTIFICATE OF SERVICE

I hereby certify that a copy of this MOTION FOR REHEARING ON APPLICATION FOR WRIT OF ERROR was served upon each of Donna C. Kline, Thomas J. Pearson, and Bank One, Texas, N.A., by mailing a copy of same via certified mail, return receipt requested, to their respective counsel of record as follows:

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Attorney for Donna C. Kline

Thomas J. Pearson
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Pro se

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The Lyric Centre
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Houston, Texas 77002

Attorney for Bank One, Texas, N.A.

This 16th day of December, 1994.

/s/ Eva C. Ramos

**APPENDIX O**

NO. 91-009787

| | | |
|---|---|---|
| Donna C. Kline | § | In the District Court of |
| | § | |
| VS. | § | Harris County, Texas |
| | § | |
| John M. O'Quinn and | § | |
| Thomas J. Pearson | § | 280th Judicial District |

***O'QUINN'S OPPOSITION TO KLINE'S APPLICATION FOR DECREE***

TO THE HONORABLE JUDGE OF SAID COURT:

COMES NOW John M. O'Quinn and respectfully files this his Opposition to Donna C. Kline's ("Kline") Application for Decree. In support thereof, John M. O'Quinn ("O'Quinn") respectfully shows the Court as follows:

***INTRODUCTION:***

1. Commencing on May 4, 1992 and continuing on various days through May 29, 1992, the Arbitration Proceeding No. 70 194 0030 91W was conducted before an Arbitration Panel. On June 23, 1992, the Arbitration Panel issued its *AWARD OF ARBITRATORS*. A severable portion of the *AWARD*, *i.e.*, Paragraph 2, exceeds the scope of the authority granted to the Arbitration Panel in the Agreement between O'Quinn, Kline and Pearson, grants relief not pled or prayed for or presented in the Arbitration Proceeding, and is contrary to the law. By his Motion to Vacate, or Alternatively, Modify and Correct Arbitration Award of September 21, 1992,

O'Quinn requested that this Court vacate the June 23, 1992 *AWARD OF ARBITRATORS* in its entirety or, alternatively, that this Court vacate Paragraph 2 of the *AWARD* and modify and correct the AWARD to award John M. O'Quinn twenty-five percent (25%) of all funds recovered by Thomas J. Pearson as attorneys fees in the *Goings v. City of Houston* litigation.

2. As detailed below, the award of exemplary damages was not authorized by the agreement among Kline, O'Quinn and Pearson; Kline did not seek punitive damages until her counsel requested such damages in a post-evidentiary brief and thus O'Quinn did not receive fair notice that Kline would seek an award of punitive damages from the arbitrators; Kline failed to comply with the requirements of Texas law that when a complainant seeks punitive damages in connection with a contract dispute, the complainant must plead and prove the existence of a separate tort which caused separate actual damages in tort; and Kline failed to comply with Texas law that in addition to pleading and proving a separate tort that caused separate actual damages, she must also pled and prove that the defendant's conduct in committing such tortious act constituted fraud, malice, or gross negligence.

3. If Kline agrees that the award of exemplary damages against O'Quinn was not authorized by the agreement among Kline, O'Quinn and Pearson; that Kline did not seek punitive damages until her counsel requested such damages in a post-evidentiary brief; that Kline did not plead and prove the existence of a separate tort which caused separate actual damages in tort; and that Kline failed to plead and prove O'Quinn conduct in committing such separate tortious act constituted fraud, malice, or gross negligence, then there is no dispute as to the material facts concerning the punitive damages portion of the *AWARD*. In such case, as a matter of

law, the *AWARD* should at the very least be partially vacated to strike Paragraph 2 thereof. But if Kline does not agree with these facts, then there exist genuine issues of material fact regarding the awarding of puniitve damages against O'Quinn, and the summary proceeding for a judgment requested by Kline is inappropriate. Consequently, O'Quinn respectfully requests that the Court deny Kline's Application for Decree.

***PARAGRAPH 2 OF THE AWARD GRANTS RELIEF EXCEEDING THE ARBITRATORS' AUTHORITY AND WHICH WAS NOT PLED OR PRAYED FOR:***

4. Arbitrators' conclusions regarding the scope of their authority and jurisdiction are subject to scrutiny by the courts to ensure that the arbitrators acted within the scope of their jurisdiction. *E.g., **E. I. Du Pont de Nemours & Co. v. Local 900***, 968 F.2d 456, 458 (5th Cir. 1992). Under the Texas General Arbitration Act, for example, this Court may vacate the entire *AWARD* or may correct or modify the *AWARD* because the Arbitration Panel exceeded the scope of its authority by awarding punitive damages. Tex. Rev. Civ. Stat. Ann. art. 237(A)(3) (vacating award) & art. 238(A)(2) (modifying or correcting award) (Vernon 1973).

5. Paragraph 2 of the *AWARD*, by which exemplary damages are awarded against O'Quinn in favor of Kline, exceeds the authority of the Arbitration Panel and grants relief not pled or prayed for. Exemplary damages may not be awarded by arbitrators where the parties have not specifically and expressly authorized the Arbitrators to do so. An award of exemplary damages was not authorized by the agreement among Kline, O'Quinn and Pearson. Paragraph 2 of the *AWARD* grants relief that was neither pled or prayed for and which was not submitted to this Arbitration Proceeding.

***The award in Paragraph 2 exceeds the authority of the Arbitration Panel:***

6. All arbitration proceedings in this State, whether conducted pursuant to the common law, the Texas General Arbitration Act, or the Federal Arbitration Act, arise out of consensual understandings. Article 224 of the Texas General Arbitration Act makes clear that a written agreement is required to compel parties to arbitrate their disputes and the terms of the written agreement govern which disputes are submitted to arbitration. Because arbitration provisions are in derogation of a right of trial by Jury, arbitration is not extended beyond the terms of the contract or to issues and matters not covered thereby. *See, e.g.,* ***Seale v. Roy M. Mitchell Contracting Co.***, 321 S.W.2d 149, 150 (Tex. Civ. App. -- Austin 1959, writ ref'd). Texas courts consistently hold that the parties must have *specifically agreed* to arbitrate the particular matter in dispute. *See, e.g.,* ***Valero Energy Corp. v. Wagner & Brown***, 777 S.W.2d 564, 566 (Tex. App. -- El Paso 1989, writ denied). The United States Supreme Court has admonished that "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed to submit." ***United Steelworkers v. Warrior & Gulf Navigation Co.***, 363 U.S. 574, 582 (1960). An award in excess of the Arbitration Panel's authority is void. *See, e.g.,* ***Couey v. Arrow Coach Lines***, 288 S.W.2d 192, 196 (Tex. Civ. App. -- Austin 1956, no writ).

7. The dispute submitted to the Arbitration Panel arises out on a written agreement entered into among Kline, O'Quinn and Pearson relating to the apportionment of legal fees received from several cases. In such agreement, there was an arbitration provision which provides as follows:

> *. . . . In the event that a dispute arises among Parties that cannot be amicably resolved or, Parties have elected to terminate this Agreement and are unable to reach an agreement to that end, said dispute shall be determined by arbitration conducted in the City of Houston, State of Texas, in accordance with the rules then in force of the American Arbitration Association.*

By this agreement, O'Quinn, Kline and Pearson did not expressly, or even by implication, grant authority to the Arbitrators to award exemplary damages in connection with disputes arising out of an alleged breach of the contract in dispute. Moreover, the arbitration provision agreed to by the parties did not include the terminology frequently found in arbitration provisions that the parties submit to arbitration any and all claims, demands, disputes, controversies, or other matters pertaining to the written agreement in issue, whether or not arising independently of the written agreement, and whether in contract, tort or otherwise. Absent such broad terminology, there was no authority in the written arbitration provision, which was written in the context of resolving contractual disputes, for the Arbitration Panel to award exemplary damages for alleged activities outside the scope of the contract.

8. Some states have specifically held that punitive damages may not be awarded at all by arbitrators, even if the parties authorized the arbitrators to award punitive damages. Some States have concluded that in view of the limited right of judicial review afforded in an arbitration proceeding, allowing arbitrators to award punitive damages would lead to consequences that are both unpredictable and uncontrollable. In ***Garrity v. Lyle Stuart, Inc.***, 40 N.Y.2d 354, 386 N.Y.S. 2d 831, 353 N.E.2d 793 (N.Y. 1976), for example, the New York Court

of Appeals held that the award of punitive damages requires judicial oversight and thus is beyond the province of arbitration proceedings. It is respectfully submitted that the same public policy considerations that caused the highest court in New York to conclude that punitive damages may not be awarded in an arbitration proceeding are also applicable in Texas. While the issue is far from settled in Texas, *see, e.g.,* ***Lone Star Cotton Mills v. Thomas***, 227 S.W.2d 300, 307 (Tex. Civ. App. -- El Paso 1949, writ ref'd n.r.e.) (holding that arbitrators must be granted authority to award even actual damages), one Texas Court of Appeals has held that the arbitrators have the power to award punitive damages -- where the parties have ***expressly*** submitted the issue to the arbitrators. ***Grissom v. Greener & Sumner Constr., Inc.***, 676 S.W.2d 709, 711 (Tex. App. -- El Paso 1984, writ ref'd). But the ***Grissom*** decision is not applicable here because the parties here did not expressly submit the issue to the arbitrators. It is respectfully that, as a matter of law, arbitrators should not be allowed to award punitive damages unless the parties have specifically and expressly granted that authority to the arbitrators.

***Kline's pleadings and presentation did not provide fair notice that she was seeking punitive damages:***

9. Due process of law also applies in arbitration proceedings just as in other legal proceedings. This means that parties are entitled to fair notice of the claims made against them. In her Plaintiff's Original Petition, a copy of which is attached to Michael O'Brien's Affidavit, Kline alleged breach of contract, breach of an alleged tort duty of good faith, and breach of an alleged fiduciary duty. Kline pled and prayed only for actual damages. Kline did not plead or pray for exemplary damages. Indeed, there is no mention -- not one single word -- in her Petition about exemplary damages. As the Affidavit

of O'Quinn's lead counsel during the Arbitration Proceeding shows, Kline did not request punitive damages in any demand or claim filed with the AAA, she did not present any testimony regarding punitive damages during the proceeding, nor did she argue any claim for punitive damages during closing argument. *See* Affidavit of Michael O'Brien, which is attached hereto as Exhibit 1.

10. Under Texas law, a pleading must provide the opponent fair notice of the claims in issue. *See, e.g.,* ***Stone v. Lawyers Title Ins. Corp.***, 554 S.W.2d 183 (Tex. 1977). The object and purpose of a pleading is to give fair and adequate notice to the party being sued of the nature of the cause of action asserted against him so he may adequately prepare his defense. *See* ***Castleberry v. Goolsby Bldg. Corp.***, 617 S.W.2d 665, 666 (Tex. 1981) (holding that claims of negligence and gross negligence are not sufficient to provide fair notice that the claimant's cause of action was actually intended to be for intentional injury).

11. Rule 56 of the Texas Rules of Civil Procedure provides that special damages must be specifically pled. Special damages are those that result from the defendant's alleged wrongful conduct but are of such an unusual nature that they normally vary with the circumstances of the individual case in which they occur. *See* ***Sherrod v. Bailey***, 580 S.W.2d 24, 28 (Tex. Civ. App. -- Houston [1st Dist.] 1970, writ ref'd n.r.e.). Exemplary damages are in the nature of special damages. In order to recover exemplary damages, there must be a specific claim for such damages or the allegations with respect to the alleged wrong must be pled in such detail as to comply with the fair notice requirements of Texas law. For example, in ***Nipper v. U-Haul Company of San Antonio***, 516 S.W.2d 467 (Tex. Civ. App. -- Beaumont 1974, no writ), the Court of Appeals exam-

ined a pleading in which the plaintiff alleged in conclusory fashion that the defendant owed her a contractual debt, that the amount of the debt "constituted trust funds of the Plaintiff in the hands of the Defendant," and that the defendant "willfully, maliciously, and fraudulently converted such funds to his own use" -- allegations which are strikingly similar to Kline's allegations. The Court of Appeals held that as a matter of law such pleadings were insufficient to support an award of exemplary damages. *Id.* at 470.

***Under Texas law, there exist unique rules applicable to efforts of plaintiffs to recover punitive damages in connection with contract disputes:***

12. In addition to failing completely to plead and pray for exemplary damages and thus failing to give fair notice to O'Quinn that she might somehow attempt to obtain punitive damages in this proceeding, there is another, perhaps even more absolute, reason why Kline as a matter of law may not be awarded exemplary damages. Texas law simply does not allow the recovery of punitive damages for breach of contract, even if the breach is intentional, willful, and malicious. *See, e.g., Manges v. Guerra*, 673 S.W.2d 184 (Tex. 1984); ***Amoco Prod. Co. v. Alexander***, 622 S.W.2d 563, 571 (Tex. 1981). Because parties continually attempt to side-step this rule by clever pleading, the Texas Supreme Court has established the rule that a complainant's ability in Texas to recover exemplary damages in connection with a breach of contract claim is subject to special rules and requirements. The Texas Supreme Court has held that in order to recover punitive damages attendant to a contract dispute a claimant must both (1) plead and (2) prove: (a) the commission of a separate tort, and (b) **that the claimant sustained separate actual damages as a result of that separate tort**. See, e.g., ***International Bank, N.A. v. Morales***, 736 S.W.2d

622, 624 (Tex. 1987); ***Texas Nat'l Bank v. Karnes***, 717 S.W.2d 901, 903 (Tex. 1986); ***Jim Walter Homes, Inc. v. Reed***, 711 S.W.2d 617, 618 (Tex. 1986); ***Bellefonte Underwriter's Ins. Co. v. Brown***, 704 S.W.2d 742, 745 (Tex. 1986).

13. Simply alleging, as Kline did, that the defaulting party to a contract allegedly also breached some tort duty, *e.g.*, fiduciary duties or an implied duty of good faith and fair dealing, will not suffice. There must also be pleading and proof that the separate and distinct tortious conduct caused the claimant to sustain separate and distinct actual damages in tort. It is only the separate actual damages in tort that will support a claim for exemplary damages! *See, e.g.*, ***International Bank***, 736 S.W.2d at 624; ***Texas Nat'l Bank***, 717 S.W.2d at 903; ***Jim Walter Homes***, 711 S.W.2d at 618; ***Bellefonte Underwriter's Ins. Co.***, 704 S.W.2d at 745.

14. In a further attempt to side-step these requirements, plaintiffs frequently argue that their economic losses in fact are their required "tort" damages. The Texas Supreme Court has rejected this argument. The Court has established the doctrine that if the actual damages sustained by the claimant are economic losses arising out of breach of the contract involved in the litigation, then no matter how the complainant disguises or characterizes her so-called tort claims, the dispute is simply one of breach of contract. *See, e.g.*, ***International Bank***, 736 S.W.2d at 624; ***Texas Nat'l Bank***, 717 S.W.2d at 903; ***Jim Walter Homes***, 711 S.W.2d at 618; ***Bellefonte Underwriter's Ins. Co.***, 704 S.W.2d at 745; and ***Amoco Prod. Co.***, 622 S.W.2d at 571. *See also* ***Crim Truck & Tractor Co. v. Navistar***, 823 S.W.2d 591, 594-95 (Tex. 1992); ***Southwestern Bell Telephone Co. v. FDP Corp.***, 811 S.W. 2d 572, 577 (Tex. 1991); ***Southwestern Bell Telephone Co. v. Delaney***, 809 S.W.2d 493, 495 (Tex. 1991).

15. In this case, there is no pleading of separate tortious conduct by O'Quinn that caused separate actual damages in tort to Kline. Kline alleged that she sustained economic losses resulting from alleged breach of contract. Kline claimed she was entitled to monies owed to her under the contract, plus interest. This Arbitration Panel's award in favor of Kline under Paragraph 1 of the *AWARD OF ARBITRATORS* makes her whole for this damage, *i.e.*, Kline recovers what this Arbitration Panel concluded she was owed under the agreement plus interest. But then Kline presented the conclusory allegations commonly found in pleadings of this nature, the allegations which the Texas Supreme Court has consistently held gives rise only to a claim for breach of contract. Kline made only the conclusory allegations that O'Quinn breached an alleged duty of good faith and breach an alleged fiduciary duty. But, even if such allegations were true, which is denied, Kline did not plead and prove any separate actual damages in tort (*e.g.*, mental anguish, etc.) caused by the alleged tortious conduct. Thus, these types of allegations do not convert the case into a tort dispute and they will not support an award of punitive damages.

16. If Kline had actually pled and proved separate actual damages in tort sustained as a result of breach of an alleged duty of good faith and fair dealing and/or an alleged fiduciary duty, this would justify the award of actual damages in tort -- but not punitive damages. A breach of the duty of good faith and fair dealing by itself does not entitle the injured party to punitive damages. A breach of a fiduciary duty by itself does not entitle the injured party to punitive damages. In order to recover exemplary damages for breach of the duty of good faith and fair dealing or breach of fiduciary duty, a complainant must also plead and prove and obtain the additional finding of fraud, malice, or gross negligence. *See Tex. Civ.*

*Prac. and Rem. Code* §41.003; ***Burk Royalty Co. v. Walls***, 616 S.W.2d 911, 922 (Tex. 1981) (addressing the issue of exemplary damages in general); ***Arnold v. Nat. County Mutual Fire Ins. Co.***, 725 S.W.2d 165, 168 (Tex. 1987) (addressing the issue of exemplary damages in connection with claim of a breach of a duty of good faith and fair dealing); ***Manges v. Guerra***, 673 S.W.2d 180, 184 (Tex. 1984) (addressing the issue of exemplary damages in connection with a claim of breach of fiduciary duty). Here, Kline did not plead or prove this additional element which is necessary to support an award of exemplary damages for breach of the alleged torts of good faith and fair dealing and/or fiduciary duty.

*Conclusion:*

17. In this case there was no pleading or prayer -- no notice whatsoever -- that Kline was thinking of asking for punitive damages. Kline did not plead the existence of a separate and distinct tort that caused separate actual damages in tort. Kline did not plead that O'Quinn had committed a separate and distinct tort in a manner that constituted fraud, malice or gross negligence. Each of these elements is required by Texas law before a claimant can recover punitive damages. Arbitration proceedings are certainly less structured than trials by Jury, but basic notions of fairness and due process still apply -- and awarding punitive damages under these circumstances violates both.

18. As described in Mr. O'Brien's Affidavit, O'Quinn never received fair notice of any request for punitive damages. Accordingly, the summary request for a "Decree" by Kline should be denied. Kline's "Application for Decree" is more in the nature of a motion for summary judgment. Because there are genuine issues of material fact about whether

O'Quinn received fair notice that Kline would request punitive damages, O'Quinn respectfully requests that this Court Deny Kline's request for such summary relief.

WHEREFORE, PREMISES CONSIDERED, John M. O'Quinn respectfully requests that this Court DENY Kline's Application for Decree and instead vacate the June 23, 1992 *AWARD OF ARBITRATORS* in its entirety or, alternatively, (i) vacate Paragraph 2 of the *AWARD, and* (ii) modify and correct the AWARD to award John M. O'Quinn twenty-five (25%) of all funds recovered by Thomas J. Pearson as attorneys fees in the *Goings v. City of Houston* litigation.

Respectfully submitted,

/s/ J. Clark Martin
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ATTORNEYS FOR
JOHN M. O'QUINN

***CERTIFICATE OF SERVICE***

I hereby certify that a copy of this O'QUINN'S OPPOSITION TO KLINE'S APPLICATION FOR DECREE was served upon each of Donna C. Kline and Thomas J. Pearson by hand delivering copies to their respective counsel of record as follows:

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Attorney for
Donna C. Kline

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Houston, Texas 77081-1006

Pro se

This 1st day of October, 1992.

/s/ J. Clark Martin
J. Clark Martin

**APPENDIX P**

NO. 91-009787

| | | |
|---|---|---|
| Donna C. Kline | § | In the District Court of |
| | § | |
| VS. | § | Harris County, Texas |
| | § | |
| John M. O'Quinn and | § | |
| Thomas J. Pearson | § | 280th Judicial District |

***O'QUINN'S MOTION TO VACATE, OR, ALTERNATIVELY, MODIFY AND CORRECT ARBITRATION AWARD***

TO THE HONORABLE JUDGE OF SAID COURT:

COMES NOW John M. O'Quinn and respectfully files this his Motion to Vacate, or, Alternatively, to Modify and Correct the June 23, 1992 Arbitration Award entered by an Arbitration Panel in connection with this Cause. In support thereof, John M. O'Quinn ("O'Quinn") respectfully shows the Court as follows:

***INTRODUCTION:***

1. Commencing on May 4, 1992 and continuing on various days through May 29, 1992, the Arbitration Proceeding No. 70 194 0030 91W was conducted before an Arbitration Panel. On June 23, 1992, the Arbitration Panel issued its *AWARD OF ARBITRATORS*, which was received by O'Quinn on June 24, 1992. Review of the *AWARD* revealed that a severable portion of the *AWARD*, *i.e.*, Paragraph 2, exceeds the scope of the authority granted to the Arbitration Panel in the

Agreement between O'Quinn, Kline and Pearson, grants relief not pled or prayed for or presented in the Arbitration Proceeding, and is contrary to the law. Review of the *AWARD* also revealed that the *AWARD* did not address an uncontroverted issue and thus there is an evident miscalculation and mistake in the description of the award to O'Quinn of monies due and owing to him by Thomas J. Pearson.

2. O'Quinn then retained undersigned counsel, who did not represent him in the Arbitration Proceedings, to review the *AWARD OF ARBITRATORS* and determine whether it was proper. Undersigned counsel for O'Quinn reviewed the AWARD and requested that the American Arbitration Association allow review of the files on the Arbitration Proceeding. The AAA refused to allow O'Quinn's counsel access to the AAA files. Undersigned counsel nevertheless prepared and presented to the AAA a Motion on behalf of O'Quinn requesting that the AWARD be partially modified or vacated. The AAA then took the position that, irrespective of the provisions of the Texas General Arbitration Act, an AAA Award may not be be modified or vacated -- indeed that a motion to modify or vacate may not even be considered by the Arbitrators -- unless all parties agree to the reinstatement of the Arbitrators. The AAA took the position that because Kline had stated she would not agree to the reinstatement of the Arbitrators, the AAA would not even present O'Quinn's Motion to the Arbitrators. That position by the AAA was incorrect. The American Arbitration Association's own Guide to Commercial Arbitration provides that an award may be modified if the parties if the law so provides. It was only after undersigned counsel requested that the issue be decided by the AAA's head office in New York that the AAA admitted its position was in error. However, the AAA and the Arbitration

Panel subsequently declined to partially modify and vacate the AWARD as required by law.

3. This Motion is timely filed pursuant to Articles 232, 237 and 238 of the Texas General Arbitration Act, and, to the extent applicable, common law arbitration principles. By this Motion, O'Quinn respectfully requests that this Court vacate the June 23, 1992 *AWARD OF ARBITRATORS* in its entirety or, alternatively, that this Court vacate Paragraph 2 of the *AWARD* and modify and correct the AWARD to award John M. O'Quinn twenty-five (25%) of all funds recovered by Thomas J. Pearson as attorneys fees in the *Goings v. City of Houston* litigation.

***PARAGRAPH 2 OF THE AWARD EXCEEDS THE AUTHORITY OF THE ARBITRATION PANEL, GRANTS RELIEF NOT PLED OR PRAYED FOR OR SUBMITTED TO THE ARBITRATION PANEL, AND IS CONTRARY TO THE LAW:***

4. Although it is often assumed that an arbitration award is entitled to great deference by the Courts, this is simply not the law. In fact, arbitrators' conclusions regarding the scope of their authority and jurisdiction are subject to scrutiny by the courts to ensure that the arbitrators acted within the scope of their jurisdiction. *E.g., **E. I. Du Pont de Nemours & Co. v. Local 900***, 968 F.2d 456, 458 (5th Cir. 1992). Under the Texas General Arbitration Act, for example, the Court may vacate the entire AWARD or may correct or modify the AWARD because the Arbitration Panel exceeded the scope of its authority by awarding punitive damages. Tex. Rev. Civ. Stat. Ann. art. 237(A)(3) (vacating award) & art. 238(A)(2) (modifying or correcting award) (Vernon 1973).

5. Paragraph 2 of the *AWARD*, by which exemplary damages are awarded against O'Quinn in favor of Kline, exceeds the authority of the Arbitration Panel, grants relief not pled or prayed for or submitted to the Arbitration Panel, and is contrary to the law for four interwoven reasons. First, an award of exemplary damages was not authorized by the agreement among Kline, O'Quinn and Pearson. Exemplary damages may not be awarded by arbitrators unless the parties have specifically and expressly authorized the Arbitrators to do so. Second, Paragraph 2 grants relief that was neither pled or prayed for and which was not submitted to this arbitration proceeding. Third, Kline failed to comply with the requirements of Texas law that when a complainant seeks punitive damages in connection with a contract dispute, the complainant must plead and prove the existence of a separate tort which caused separate actual damages in tort. It is only such separate actual damages in tort which can legally support the requested exemplary damages. Fourth, Kline failed to comply with Texas law that in addition to pleading and proving a separate tort that caused separate actual damages, she must also pled and prove that the defendant's conduct in committing such tortious act constituted fraud, malice, or gross negligence.

***The award in Paragraph 2 exceeds the authority of the Arbitration Panel:***

6. All arbitration proceedings in this State, whether conducted pursuant to the common law, the Texas General Arbitration Act, or the Federal Arbitration Act, arise out of consensual understandings. Article 224 of the Texas General Arbitration Act makes clear that a written agreement is required to compel parties to arbitrate their disputes and the terms of the written agreement govern which disputes are submitted to arbitration. Because arbitration provisions are in

derogation of a right of trial by Jury, arbitration is not extended beyond the terms of the contract or to issues and matters not covered thereby. *See, e.g.,* ***Seale v. Roy M. Mitchell Contracting Co.***, 321 S.W.2d 149, 150 (Tex. Civ. App. -- Austin 1959, writ ref'd). Texas courts consistently hold that the parties must have *specifically agreed* to arbitrate the particular matter in dispute. *See, e.g.,* ***Valero Energy Corp. v. Wagner & Brown***, 777 S.W.2d 564, 566 (Tex. App. -- El Paso 1989, writ denied). The United States Supreme Court has admonished that "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed to submit." ***United Steelworkers v. Warrior & Gulf Navigation Co.***, 363 U.S. 574, 582 (1960). An award in excess of the Arbitration Panel's authority is void. *See, e.g.,* ***Couey v. Arrow Coach Lines***, 288 S.W.2d 192, 196 (Tex. Civ. App. -- Austin 1956, no writ).

7. The dispute submitted to this Arbitration Panel arises out on a written agreement entered into among Kline, O'Quinn and Pearson relating to the apportionment of legal fees received from several cases. In such agreement, there was an arbitration provision which provides as follows:

> *. . . . In the event that a dispute arises among Parties that cannot be amicably resolved or, Parties have elected to terminate this Agreement and are unable to reach an agreement to that end, said dispute shall be determined by arbitration conducted in the City of Houston, State of Texas, in accordance with the rules then in force of the American Arbitration Association.*

By this agreement, O'Quinn, Kline and Pearson did not expressly, or even by implication, grant authority to the Arbitra-

tors to award exemplary damages in connection with disputes arising out of an alleged breach of the contract in dispute. Moreover, the arbitration provision agreed to by the parties did not include the terminology frequently found in arbitration provisions that the parties submit to arbitration any and all claims, demands, disputes, controversies, or other matters pertaining to the written agreement in issue, whether or not arising independently of the written agreement, and whether in contract, tort or otherwise. Absent such broad terminology, there was no authority in the written arbitration provision, which was written in the context of resolving contractual disputes, for the Arbitration Panel to award exemplary damages for alleged activities outside the scope of the contract.

8. In this case, as will be discussed below, the only alleged activities that could have possibly given rise to punitive damages would have been activities outside the agreement. This is because Texas law does not allow the recovery of exemplary damages for breach of contract. Additionally, because of the unique and harsh nature of punitive damages, it is inappropriate to simply assume that the parties intended this arbitration provision to authorize the arbitrators to award punitive damages for outside-the-contract activities. This judicial philosophy is reflected in ***Decision Controls Systems, Inc. v. Personnel Cost Control, Inc.***, 787 S.W.2d 98 (Tex. App. -- Dallas 1990, no writ), wherein the Dallas Court of Appeals held that an arbitration provision which did not clearly specify that the parties would arbitrate DTPA claims arising independently of the contract was not specific enough to include such claims. The arbitration provision in the contract among Kline, O'Quinn and Pearson certainly did not specifically authorize the Arbitration Panel to award punitive damages for activities for which punitive damages may not be awarded under Texas law, *i.e.*, for breach of contract. And similar to ***Decision Con-***

***trols Systems***, the arbitration provision did not specifically authorize the Arbitration Panel to award punitive damages for outside-the-contract activities. As such, it is respectfully urged that this Arbitration Panel exceeded its authority in awarding punitive damages.

9. Some states have specifically held that punitive damages may not be awarded by arbitrators, even if the parties authorized the arbitrators to award punitive damages. Some States have concluded that in view of the limited right of judicial review afforded in an arbitration proceeding, allowing arbitrators to award punitive damages would lead to consequences that are both unpredictable and uncontrollable. In ***Garrity v. Lyle Stuart, Inc.***, 40 N.Y.2d 354, 386 N.Y.S. 2d 831, 353 N.E.2d 793 (N.Y. 1976), for example, the New York Court of Appeals held that the award of punitive damages requires judicial oversight and thus is beyond the province of arbitration proceedings. It is respectfully submitted that the same public policy considerations that caused the highest court in New York to conclude that punitive damages may not be awarded in an arbitration proceeding are also applicable in Texas. While the issue is far from settled in Texas, *see, e.g.*, ***Lone Star Cooten Mills v. Thomas***, 227 S.W.2d 300, 307 (Tex. Civ. App. -- El Paso 1949, writ ref'd n.r.e.) (holding that arbitrators must be granted authority to award even actual damages), one Texas Court of Appeals has held that the arbitrators have the power to award punitive damages -- where the parties have ***expressly*** submitted the issue to the arbitrators. ***Grissom v. Greener & Sumner Constr., Inc.***, 676 S.W.2d 709, 711 (Tex. App. -- El Paso 1984, writ ref'd). But the ***Grissom*** decision is not applicable here because the parties here did not expressly submit the issue to the arbitrators. It is respectfully that, as a matter of law, arbitrators should not be allowed to award punitive damages

unless the parties have specifically and expressly granted that authority to the arbitrators.

***The relief granted in Paragraph 2 was not pled or prayed for, and was not submitted to the Arbitration Panel:***

10. Due process of law applies in arbitration proceedings just as in other legal proceedings. This means that parties are entitled to fair notice of the claims made against them. Assuming that O'Quinn, Kline and Pearson had intended for the arbitration clause in their contract to extend to extra-contractual activities and had specifically and expressly authorized the Arbitration Panel to hear and decide such matters and to award both actual and punitive damages in connection with such activities, this is not a case in which Kline pled or prayed for punitive damages from O'Quinn.

11. Under Texas law, a pleading must provide the opponent fair notice of the claims in issue. *See, e.g., **Stone v. Lawyers Title Ins. Corp.***, 554 S.W.2d 183 (Tex. 1977). The object and purpose of a pleading is to give fair and adequate notice to the party being sued of the nature of the cause of action asserted against him so he may adequately prepare his defense. *See **Castleberry v. Goolsby Bldg. Corp.***, 617 S.W.2d 665, 666 (Tex. 1981) (holding that claims of negligence and gross negligence are not sufficient to provide fair notice that the claimant's cause of action was actually intended to be for intentional injury). The claim that Kline presented to the Arbitration Panel in this Proceeding is defined by her *PLAINTIFF'S ORIGINAL PETITION* filed in State court. By letter of May 28, 1991 from Mr. Norman Riedmueller to Ms. Tamme S. Wilkes of the American Arbitration Association, Mr. Riedmueller transmitted such pleading to the American Arbi-

tration Association as the definition of Kline's claim. In her Petition, Kline alleged breach of contract, breach of an alleged tort duty of good faith, and breach of an alleged fiduciary duty. Kline pled and prayed only for actual damages. Kline did not plead or pray for exemplary damages. Indeed, there is no mention -- not one single word -- in her Petition about exemplary damages. *See PLAINTIFF'S ORIGINAL PETITION.*

12. Rule 56 of the Texas Rules of Civil Procedure provides that special damages must be specifically pled. Special damages are those that result from the defendant's alleged wrongful conduct but are of such an unusual nature that they normally vary with the circumstances of the individual case in which they occur. *See* ***Sherrod v. Bailey***, 580 S.W.2d 24, 28 (Tex. Civ. App. -- Houston [1st Dist.] 1970, writ ref'd n.r.e.). Rule 56 recognizes that special damages are completely unlike general damages, the latter being so usual an accompaniment of the kind of wrongdoing alleged in the pleading that the mere allegation of the wrong gives the opposing party fair notice. Exemplary damages are in the nature of special damages. Exemplary damages are allowed only as a result of the defendant's wrongful conduct and such damages vary with the circumstances of the individual case in which they occur and with the conduct of the individual defendants involved in the case. In order to recover exemplary damages, there must be a specific claim for such damages or the allegations with respect to the alleged wrong must be pled in such detail as to comply with the fair notice requirements of Texas law. For example, in ***Nipper v. U-Haul Company of San Antonio***, 516 S.W.2d 467 (Tex. Civ. App. -- Beaumont 1974, no writ), the Court of Appeals examined a pleading in which the plaintiff alleged in conclusory fashion that the defendant owed her a contractual debt, that the amount of the debt "constituted trust funds of the Plaintiff in the hands of the Defendant," and that the

defendant "willfully, maliciously, and fraudulently converted such funds to his own use" -- allegations which are strikingly similar to Kline's allegations. The Court of Appeals held that as a matter of law such pleadings were insufficient to support an award of exemplary damages. *Id.* at 470.

13. In this case there was no pleading or prayer -- no notice whatsoever -- that Kline was thinking of asking for punitive damages. As will be discussed in the following sections of this Motion, Kline did not plead the existence of a separate and distinct tort that caused separate actual damages in tort. Kline did not plead that O'Quinn had committed a separate and distinct tort in a manner that constituted fraud, malice or gross negligence. Each of these elements is required by Texas law before a claimant can recover punitive damages. Lawyers who are trained to recognize the necessary elements of a claim for punitive damages simply could not have known from Kline's pleadings that she was thinking about attempting to recover punitive damages. The law does not require them to guess as what Kline might be secretly planning. Although undersigned counsel was not in attendance when this case was presented to the Arbitration Panel, it is my understanding that O'Quinn and his trial counsel did not know that Kline was pleading to seek exemplary damages until after the evidentiary portion of the proceeding had been closed. It is my understanding that it was only then, with no pleading to support the claim and with the issue not having previously been presented, that Kline asked for punitive damages. Arbitration proceedings are certainly less structured than trials by Jury, but basic notions of fairness and due process still apply -- and awarding punitive damages under these circumstances violates both.

***Under Texas law, there exist unique rules applicable to efforts of plaintiffs to recover punitive damages in connection with contract disputes:***

14. In addition to failing completely to plead and pray for exemplary damages and thus failing to give fair notice to O'Quinn that she might somehow attempt to obtain punitive damages in this proceeding, there is another, perhaps even more absolute, reason why Kline as a matter of law may not be awarded exemplary damages. Texas law simply does not allow the recovery of punitive damages for breach of contract, even if the breach is intentional, willful, and malicious. *See, e.g.*, ***Manges v. Guerra***, 673 S.W.2d 184 (Tex. 1984); ***Amoco Prod. Co. v. Alexander***, 622 S.W.2d 563, 571 (Tex. 1981). Because plaintiffs continually attempt to side-step this rule by clever pleading, the Texas Supreme Court has established the rule that a complainant's ability in Texas to recover exemplary damages in connection with a breach of contract claim is subject to special rules and requirements. The Texas Supreme Court has held that in order to recover punitive damages attendant to a contract dispute a claimant must both (1) plead and (2) prove: (a) the commission of a separate tort, and (b) **that the claimant sustained separate actual damages as a result of that separate tort**. See, e.g., ***International Bank, N.A. v. Morales***, 736 S.W.2d 622, 624 (Tex. 1987); ***Texas Nat'l Bank v. Karnes***, 717 S.W.2d 901, 903 (Tex. 1986); ***Jim Walter Homes, Inc. v. Reed***, 711 S.W.2d 617, 618 (Tex. 1986); ***Bellefonte Underwriter's Ins. Co. v. Brown***, 704 S.W.2d 742, 745 (Tex. 1986).

15. Simply alleging, as Kline did, that the defaulting party to a contract allegedly also breached some tort duty, *e.g.*, fiduciary duties or an implied duty of good faith and fair dealing, will not suffice. There must also be pleading and proof that the separate and distinct tortious conduct caused the

claimant to sustain separate and distinct actual damages in tort. It is only the separate actual damages in tort that will support a claim for exemplary damages! *See, e.g.,* ***International Bank***, 736 S.W.2d at 624; ***Texas Nat'l Bank***, 717 S.W.2d at 903; ***Jim Walter Homes***, 711 S.W.2d at 618; ***Bellefonte Underwriter's Ins. Co.***, 704 S.W.2d at 745.

16. In a further attempt to side-step these requirements, plaintiffs frequently argue that their economic losses in fact are their required "tort" damages. The Texas Supreme Court has rejected this argument. The Court has established the doctrine that if the actual damages sustained by the claimant are economic losses arising out of breach of the contract involved in the litigation, then no matter how the complainant disguises or characterizes her so-called tort claims, the dispute is simply one of breach of contract. *See, e.g.,* ***Crim Truck & Tractor Co. v. Navistar***, 823 S.W.2d 591, 594-95 (Tex. 1992); ***Southwestern Bell Telephone Co. v. FDP Corp.***, 811 S.W. 2d 572, 577 (Tex. 1991); ***Southwestern Bell Telephone Co. v. Delaney***, 809 S.W.2d 493, 495 (Tex. 1991); ***International Bank***, 736 S.W.2d at 624; ***Texas Nat'l Bank***, 717 S.W.2d at 903; ***Jim Walter Homes***, 711 S.W.2d at 618; ***Bellefonte Underwriter's Ins. Co.***, 704 S.W.2d at 745; and ***Amoco Prod. Co.***, 622 S.W.2d at 571.

17. In this case, there is no pleading of separate tortious conduct by O'Quinn that caused separate actual damages in tort to Kline. Kline alleged that she sustained economic losses resulting from alleged breach of contract. Kline claimed she was entitled to monies owed to her under the contract, plus interest. This Arbitration Panel's award in favor of Kline under Paragraph 1 of the *AWARD* makes her whole for this damage, *i.e.*, Kline recovers what this Arbitration Panel concluded she was owed under the agreement plus

interest. But then Kline presented the conclusory rhetoric commonly found in pleadings of this nature, the rhetoric which the Texas Supreme Court has consistently held gives rise only to a claim for breach of contract. Kline made the conclusory allegations that O'Quinn breached an alleged duty of good faith and breach an alleged fiduciary duty. But, even if such allegations were true, which is denied, Kline did not plead and prove any separate actual damages in tort (*e.g.*, mental anguish, etc.) caused by the alleged tortious conduct. Thus, while these other extraneous allegations may sound bad (in fact, that is why plaintiffs usually add them into their petition when suing on a contract), they do not convert the case into a tort dispute and they will not support an award of punitive damages.[1]

18. Although, as stated above, undersigned counsel was not in attendance when this case was presented to the Arbitration Panel, it is my understanding that the case was tried the same way it is pled. That is, there was no evidence presented of separate tortious conduct by O'Quinn that caused separate actual damages in tort to Kline (*e.g.*, mental anguish damages, etc.) that could even function as the basis for an award of exemplary damages against O'Quinn. As stated above, it is my understanding that no discussion of exemplary damages occurred until after the evidence had been presented

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[1] In most situations where a plaintiff is suing on a contract and is also attempting to recover exemplary damages, the plaintiff at least pleads that he or she is seeking exemplary damages. This at least gives the defendant fair notice of the plaintiff's intentions. But here Kline not only failed to plead and prove separate actual damages in tort to support an award of exemplary damages -- but did even plead or pray for exemplary damages at all!

to the Arbitration Panel and then, only after the evidentiary portion of the proceeding was concluded, Kline submitted a *Post-Evidence/Pre-Summation Brief* arguing for exemplary damages. But there was no pleading or proof that complied with Texas law which could possibly support this late attempt to inject punitive damages into this Arbitration Proceeding.

***Even if all other required elements had been pled and proven, Kline failed to plead and prove the type of intentional conduct necessary to support an award of punitive damages:***

19. Assume for the moment that Kline had actually pled and proved separate actual damages in tort sustained as a result of breach of an alleged duty of good faith and fair dealing and/or an alleged fiduciary duty. Even this would not justify the award of punitive damages. A breach of the duty of good faith and fair dealing by itself does not entitle the injured party to punitive damages. A breach of a fiduciary duty by itself does not entitle the injured party to punitive damages. In order to recover exemplary damages for breach of the duty of good faith and fair dealing or breach of fiduciary duty, a complainant must also plead and prove and obtain the additional finding of fraud, malice, or gross negligence. *See Tex. Civ. Prac. and Rem. Code* §41.003; ***Burk Royalty Co. v. Walls***, 616 S.W.2d 911, 922 (Tex. 1981) (addressing the issue of exemplary damages in general); ***Arnold v. Nat. County Mutual Fire Ins. Co.***, 725 S.W.2d 165, 168 (Tex. 1987) (addressing the issue of exemplary damages in connection with claim of a breach of a duty of good faith and fair dealing); ***Manges v. Guerra***, 673 S.W.2d 180, 184 (Tex. 1984) (addressing the issue of exemplary damages in connection with a claim of breach of fiduciary duty). Here, Kline did not plead, *see PLAINTIFF'S ORIGINAL PETITION*, or prove this additional element which

is necessary to support an award of exemplary damages for breach of the alleged torts of good faith and fair dealing and/or fiduciary duty.

***Summary with respect to Paragraph 2 of the AWARD:***

20. Therefore, it is respectfully moved that this Court vacate Paragraph 2 of the AWARD and thus modify it on the grounds that, first, the arbitrators were not granted authority to award exemplary damages by the parties' arbitration agreement; second, Kline did not even plead or pray for exemplary damages from O'Quinn and only raised the issue for the first time in a brief filed after the evidentiary portion of the proceeding was concluded; third, as a matter of law Kline is not entitled to recover punitive damages from O'Quinn because she failed to plead and prove a separate tort that caused separate actual damages in tort, which is a legal requirement for an award of exemplary damages; and fourth, as a matter of law Kline is not entitled to recover punitive damages from O'Quinn because she failed to plead and prove the type of conduct on the part of O'Quinn in connection with separate tortious conduct (*i.e.*, separate from the alleged breach of contract) that is legally necessary to support an award of punitive damages, *i.e.*, fraud, malice, or gross negligence.

21. As mentioned above, the four reasons why the *AWARD* must be vacated and/or modified are interwoven. This Motion began with a discussion of the point that the Arbitration Panel exceeded its authority because it was not authorized by the written arbitration agreement to award punitive damages. The other three points discussed in this Motion bring the reasoning full circle. An award of punitive damages for breach of contract is so remarkably and fundamentally contrary to

Texas law that the parties -- all of whom are personal injury trial lawyers familiar with these legal principles -- could not and did not intend to grant the Arbitration Panel the authority to do so. Awarding punitive damages for alleged extra-contractual activities when the claimant did not comply, and could not comply, with the requirements of Texas law (*i.e.*, Kline failed to plead and prove a separate and distinct tort that caused separate and distinct actual damages and failed to plead and prove that such tortious conduct constitute fraud, malice, or gross negligence) is also so fundamentally contrary to Texas law that the parties could not and did not intend such result. Moreover, awarding punitive damages when the claimant did not even request such damages except as an after-thought violates due process and fundamental notions of fairness. Taken together, these points establish that allowing Paragraph 2 of the AWARD to stand not only exceeds the Arbitration Panel's authority but also constitutes a manifest disregard of the law. Such a disregard of the law constitutes a non-statutory ground for vacating the award. *See, e.g.*, ***American Postal Workers v. United States Postal Service***, 682 F.2d 1280, 1284 (9th Cir. 1982), *cert. denied*, 459 U.S. 1200 (1983).

***THE AWARD ALSO FAILS TO PROVIDE O'QUINN RELIEF THAT WAS UNCONTROVERTED:***

22. The *AWARD* contains an evident material miscalculation or mistake in the description of the monetary recovery due the parties. It is the understanding of undersigned counsel that the uncontroverted testimony presented with respect to the *Goings v. City of Houston* case established that Pearson recovered over $1.4 Million as a result of post litigation settlement. It is respectfully submitted that under the contract on which the Arbitration Panel based its award in Paragraphs 1, 3, 4, 5, and 6 of the *AWARD*, the Arbitration

Panel was presented uncontroverted evidence that Pearson agreed to pay, and should have paid, O'Quinn 25% of the attorneys fees Pearson received in the *Goings* case. It is undersigned counsel's understanding that Person admitted he collected and retained all of the attorneys' fees in the *Goings* case.

23. Therefore, O'Quinn respectfully requests that this Court modify the *AWARD* to award O'Quinn twenty-five (25%) of all funds recovered by Thomas J. Pearson as attorneys fees in the *Goings v. City of Houston* litigation.

WHEREFORE, PREMISES CONSIDERED, John M. O'Quinn respectfully requests that this Court vacate the June 23, 1992 *AWARD OF ARBITRATORS* in its entirety or, alternatively, that this Court (i) vacate Paragraph 2 of the *AWARD,* (ii) modify and correct the AWARD to award John M. O'Quinn twenty-five (25%) of all funds recovered by Thomas J. Pearson as attorneys fees in the *Goings v. City of Houston* litigation, and (iii) such other and further relief, both general and special, to which John M. O'Quinn may show himself justly entitled.

Respectfully submitted,

/s/ J. Clark Martin
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***CERTIFICATE OF SERVICE***

I hereby certify that a copy of this O'QUINN'S MOTION TO PARTIALLY VACATE, OR ALTERNATIVELY MODIFY AND CORRECT ARBITRATION AWARD was served upon each of Donna C. Kline and Thomas J. Pearson by delivering copies to the United States Postal Service, certified mail, postage prepaid, addressed to their respective counsel of record as follows:

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This 21st day of September, 1992.

/s/ Steven R. Borgman
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